Life Insurance 101

By Glenn Cooke, BMath, FLMI

About the Author

Glenn Cooke (aka The Term Guy) is a Canadian life insurance broker who's been in the insurance industry since 1986. After a short stint in the actuarial department of a life insurance company, he left the corporate world and became licensed as a broker.

From there, Glenn helped revolutionize the online life insurance world in Canada. Starting in 2006, he was one of the first Canadian life insurance brokers to work primarily online. He was the first advisor able to pass the compliance requirements for this non-face to face business model with a number of life insurance companies, and his policies and procedures were used by life insurance companies as a model for other brokers. He was also one of the first life insurance brokers in Canada to go completely paperless, almost 2 decades ago.

In 2020, The Term Guy went completely online, offering Canadians the ability to purchase life insurance without a broker present or on the phone. Without a broker present however, Canadians often need advice or information about life insurance. This is particularly true given the conflicting sales information often found online. This book is intended to fill that need.

Over the last two decades, Glenn has been quoted in almost every daily national newspaper in Canada (Globe and Mail, Toronto Star, etc) been interviewed on TV and Radio, quoted in magazines such as Canadian Moneysaver, featured in independent financial blogs, and used as a source for insurance industry magazines. He's also been used as a source for books written by consumer advocates such as Preet Banerjee and Gail Vaz-Oxlade.

Glenn has a BMath with a minor in Actuarial Science. He's currently completing a Masters of Math, Teaching at the University of Waterloo. In his spare time outside of work, school, and family, he introduces other university students to the wonders of Canada's outdoors by taking them fishing, camping, and hunting.

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Life Insurance Fundamentals

Before we can really get started, there's a couple of basic principles of insurance that we need to get a handle on. Doing so will let us properly identify the loss we experience. And once we know the correct loss, we can then quickly determine the correct amount of insurance (enough to cover the loss) and the correct type of insurance.

Our Goal

Our goal with life insurance is to look after our family in the event of our premature death. We clarify this to actually mean that we want to maintain our family's current lifestyle or standard of living as it is now.

This means that we have to somehow translate this goal into financial terms, and specifically something that is lost financially in the event of our death – and that that loss would impact our family's standard of living. Breaking down insurance into it's basic concepts will allow us to find an answer to this problem.

Random Event & Catastrophic Financial Loss

For any type of insurance to make sense, we need two things to happen.

The first is a random event. Something unexpected, isn't planned for and can't really be prevented. This random event then needs to cause the second thing - a specific financial loss.

The financial loss is what we're actually insuring. The random event happens, we suffer a financial loss and the insurance compensates us for the amount of the loss. In that fashion, we don't benefit from our loss (the insurance doesn't pay more than the loss) but we don't suffer either (since we end up financially right were we were before).

Now, these are two distinct concepts, but consumers generally intermingle the two. For our purposes, we need to keep them separate. We're going to match our insurance amounts and type to the financial loss, so we're going to focus on that concept. The random event is almost arbitrary – we don't care about it other than that it could happen. Other than that, we can ignore it for the purposes of figuring out our life insurance.

With life insurance, the random event that happens is our death. We pass away, and that causes an as yet undetermined financial loss. At this point we can pretty much ignore this for the purposes of insurance because <u>we're not insuring our life</u>. We're insuring something that's lost upon our death that we can measure financial.

So what is the financial loss? Lets start by looking back at our goal. Our goal is to maintain our family's lifestyle in the event of our death. If we can reshape that goal as a financial loss, we'll be able to match the insurance to that loss.

Well, what is our family's lifestyle? It's our home, our cars, our groceries, our savings. All the 'things' that we have, buy, and spend or save money on.

Extending this further, where does the money come from to pay for all of that lifestyle? For most of us,it's our income or our paycheque. We go to work every day, earn a paycheque, bring it home and spend it or save it. It's that 'spending' on bills and non-necessities that create our lifestyle. And now we've uncovered what the financial loss is in the event of our death – it's our income.

If things go as planned, we live a long healthy life and earn a paycheque until retirement. That paycheque funds our lifestyle. If we die prematurely however, our family loses that income – our family income drops by the amount of our paycheque. If we use life insurance to somehow replace the amount of that paycheque over time, then our family has the same amount of money each year. They can continue to pay the same bills they were before, and thus continue to live in the same lifestyle. And that means that we've accomplished our goal with life insurance.

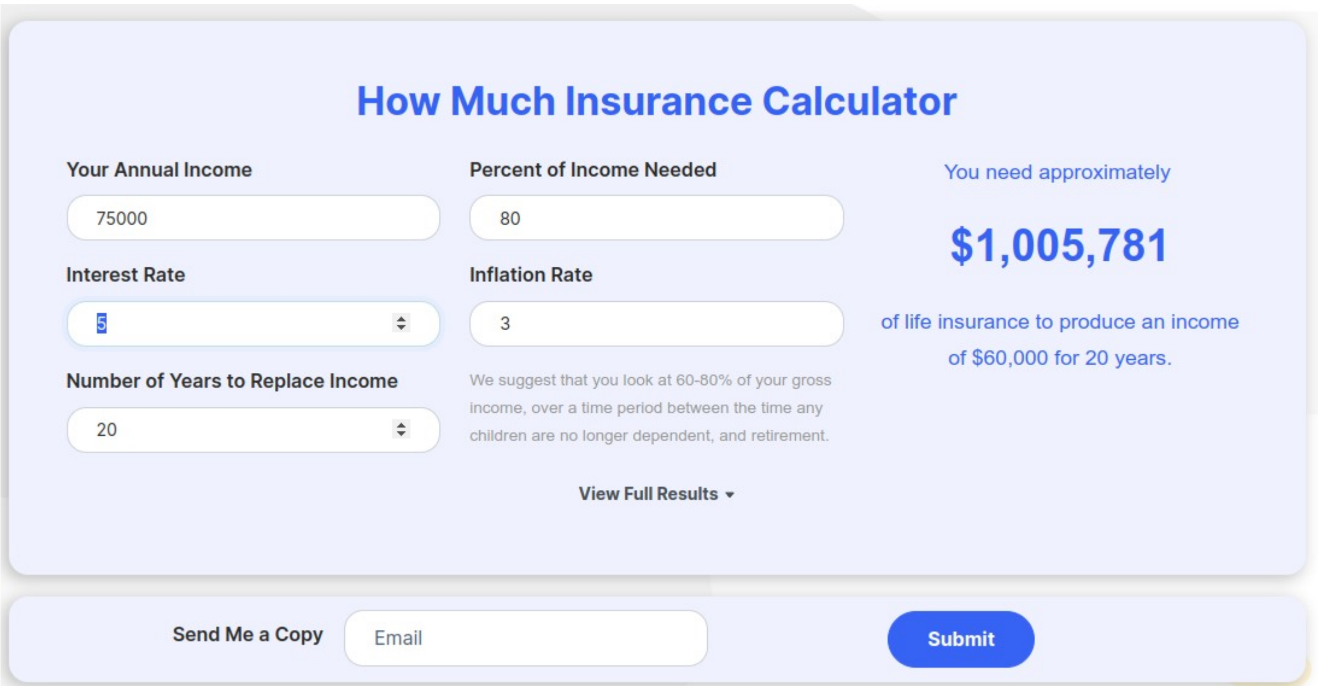
With life insurance, we are not insuring our life. We are insuring our paycheque. Our paycheque lets our family continue to maintain their existing lifestyle – no more, no less.

How Much Life Insurance Do I Need?

In the last section we saw that to protect our family in the event of our premature death, that what we were actually insuring was our paycheque.

Our paycheque is a stream of income across the years until retirement. Life insurance however is paid out all at once. We need to connect these two concepts. To do that, we are going to use a calculator that converts a stream of income, into a one time payment.

This calculator is available on our website homepage.



There are 5 inputs, lets go through them one at a time.

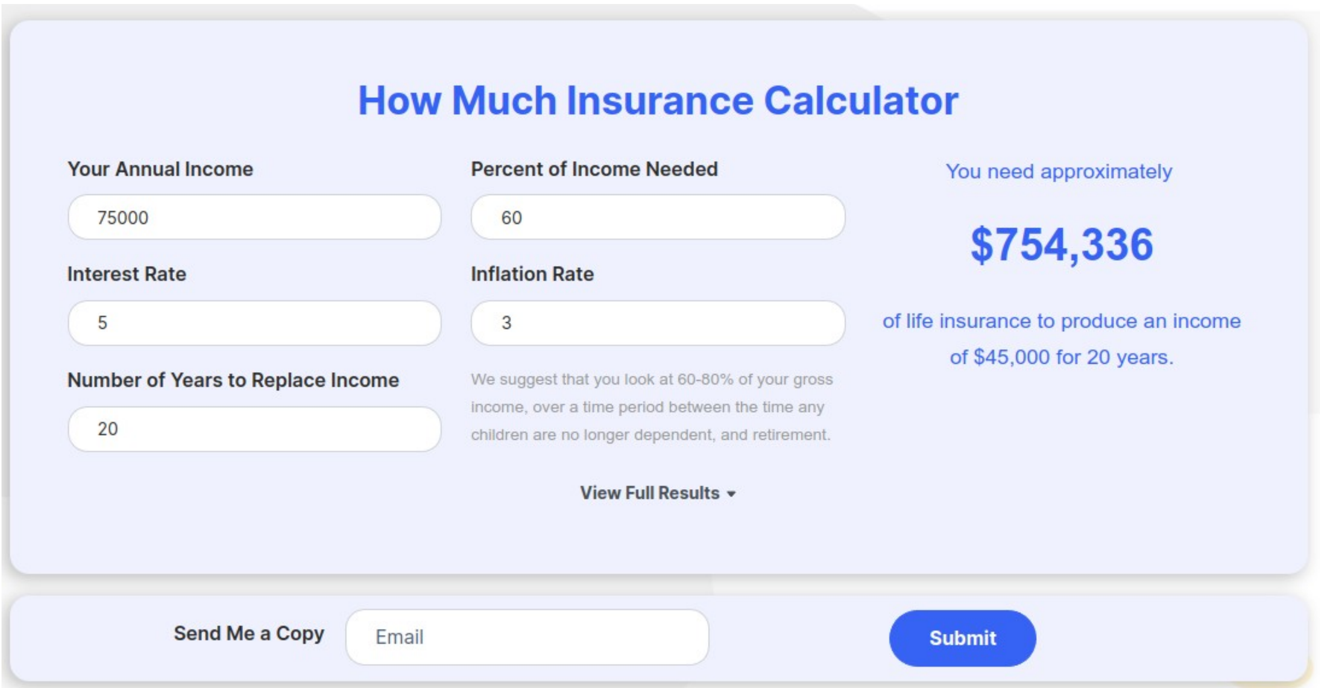
1. Your Annual Income – this is just your gross annual income. For our example, I'm going to use $75,000.
2. Percent of Income Needed – this assumes that your family doesn't need all of your income in order to maintain their lifestyle. At a minimum, we have one less person (you) eating groceries and putting gas in the car. Commonly Canadians will use 60%-80%. For our example I'm going to use 80% to start.

3. Interest – a conservative interest rate. More aggressive interest rates lead to lower insurance amounts, but also require that our family obtain those aggressive interest rates. I'll use 5% in our example.
4. Inflation – this lets us to assume that your income increases roughly with inflation over time. The easiest way to see this is to look at your income 20 years ago. Could you maintain your current lifestyle at that income? Probably not. Accounting for inflation lets our 'insurance' paycheque keep up with increases in the cost of groceries, gas, and everything else that contributes to our lifestyle. A rule of thumb is to use an inflation rate that's 2% lower than interest. I'll use 3% in this example.
5. Number of Years to Replace Income – if you pass away tomorrow, how long do we want to maintain your family's standard of living for? Common answers would be 'until retirement' or 'until the youngest child is on their own and self sufficient'. I'll use 20 years to start our example.

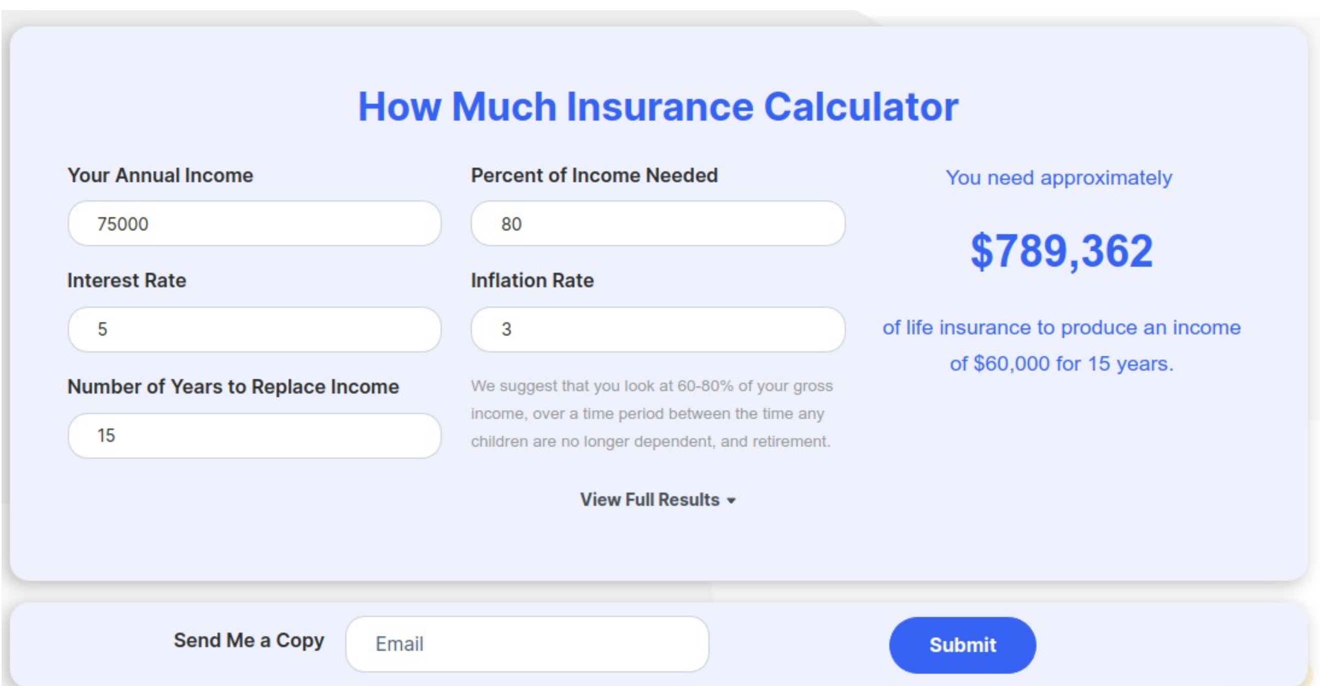
Using the above example in the calculator, we see that it takes 1.005 million. 1.005 million of life insurance will exactly produce 80% of a $75,000 income, over 20 years. At the end of the 20 years there's no money left.

Now, the assumptions we used had a lot of variability in them, which gives us a final answer that also has a lot of variability. So rather than treating the 1.005 million as the final answer, we instead want to change the inputs to get a sense of how those changes impact the amount of life insurance we need.

Lets change the Percent of Income Needed to 60% from 80%. This gives us an answer of $759,000 of life insurance. We now have a better answer – if we want to replace 60%-80% of our income, we should have about $750,000-$1,000,000 of life insurance.



Now lets change the 60% back to 80% then change the Number of Years to Replace Income to 15 years. This produces a life insurance coverage amount of $789,000. Good news – that's still within our range of $750,000-$1,000,000.



We can see now that for this example, our inputs still give us a coverage range of $750,000-$1,000,000. You should continue to try different inputs until you have a fairly consistent range of life insurance coverage amounts.

For the above example, if we get much more than $1,000,000 of life insurance we're getting a bit overinsured. If we get much less than $750,000 of coverage, we're underinsured – we now know that if we pass away that our family won't be able to continue in their current lifestyle for the full timeframe – at some point they're going to run out of money and have to cut back.

Lastly, the calculator produces an actual year by year breakdown to show you how it works. Below the calculator, click on the "View Full Results" which will show you a table with the initial life insurance amount being drawn down producing an income every year, until there's no money left.

View Full Results ▾

Understanding Your Results

Year	Insurance	- Income	+ Interest	= Remaining Insurance
1	1,005,781.36	60,000.00	47,289.07	993,070.43
2	993,070.43	61,800.00	46,563.52	977,833.95
3	977,833.95	63,654.00	45,709.00	959,888.95
4	959,888.95	65,563.62	44,716.27	939,041.60
5	939,041.60	67,530.53	43,575.55	915,086.62
6	915,086.62	69,556.44	42,276.51	887,806.69
7	887,806.69	71,643.14	40,808.18	856,971.73
8	856,971.73	73,792.43	39,158.96	822,338.26
9	822,338.26	76,006.20	37,316.60	783,648.66
10	783,648.66	78,286.39	35,268.11	740,630.38
11	740,630.38	80,634.98	32,999.77	692,995.17
12	692,995.17	83,054.03	30,497.06	640,438.19
13	640,438.19	85,545.65	27,744.63	582,637.16
14	582,637.16	88,112.02	24,726.26	519,251.40
15	519,251.40	90,755.38	21,424.80	449,920.81
16	449,920.81	93,478.04	17,822.14	374,264.91
17	374,264.91	96,282.39	13,899.13	291,881.65
18	291,881.65	99,170.86	9,635.54	202,346.33
19	202,346.33	102,145.98	5,010.02	105,210.36
20	105,210.36	105,210.36	0.00	0.00

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At this point, all we're going to do is define a fairly tight range, often within about $250,000. You can then start to firm up your decision once you start to run quotes (which we'll do after we determine what the best type of life insurance is).

Types of Life Insurance

Aside: Guarantees

Life insurance policies are held for decades, often an entire lifetime. With such long timeframes, things can and do go wrong. Therefore it's important that your life insurance policy be fully guaranteed – both the premiums and the coverage amount.

You should only consider life insurance policies that are fully guaranteed, and thus we won't be covering non-guaranteed life insurance policies in this ebook.

Aside: Life Insurance As An Investment

Some life insurance policies have investment options or attributes that are similiar to investments. In all cases, RRSP's and TFSA's are going to be better investments than anything available in a life insurance policy and therefore you should avoid co-mingling your life insurance and investments. If you want investments and savings, seek out a professional investment advisor and use tax advantaged vehicles like RRSP's and TFSA's.

You should not be looking at life insurance as an investment, and thus we won't be covering life insurance as an investment in this ebook.

Note: Once you have maximized your RRSP's and TFSA's and have additional investment opportunities, life insurance can become a very attractive investment. But until that point, stick to life insurance for insurance purposes.

Premiums Determine The Type

There's two primary attributes that we care about with life insurance; the amount of coverage (the insurance) and the premiums we pay for that coverage.

If you've been looking at different 'types', you may get the impression that once type of policy is better than another. This is a misconception. In fact, there's only ONE type of life insurance coverage – the one that pays a death benefit. For example, if two people have two different 'types' of life insurance for $1,000,000 and they both pass away then their family's both receive an identical $1,000,000 cheque. There's no difference in the coverage!

Recognizing that for a given coverage amount, all life insurance policies have the same benefit (they're the same 'product'), then the difference in the different types of life insurance has to be with the premiums. And this turns out to be the case.

More specifically, we generate the different types of life insurance policies by creating different ways to pay the cost of life insurance over long periods of time. A simile would be if we all bought the same car, but choose to pay either through a car loan, by leasing, or by paying cash upfront. Same car, different payment methods.

Term Life Insurance

One Year Term

Life insurance is more expensive as we get older. Life insurance at age 41 is more expensive than at age 40 and it's more expensive at age 42 than it is at age 41. If we paid our life insurance premiums to cover these costs on a per-yearly-cost basis, our life insurance premiums would go up every year. This type of life insurance is called one year term and is the fundamental type of life insurance – it's the basis for all the other types.

Consumers however don't like to lock in life insurance policies over 10,20 or even as long as 30 years where the premiums go up every year. So what can we do?

10 year Term

Lets say you need life insurance for 10 years. We can take the increasing costs of one year term and average them out over 10 years. That gives us a structure where the premiums are level for 10 years. After that time,we would kick back over to the one year term premiums at our now older age, This type of life insurance policy is called a 10 year term.

20 Year Term

Now lets assume that we need life insurance for 20 years. One year term isn't suitable. 10 year term doesn't work either, because at the end of year 10 we're again looking at ever-increasing costs.

What we can do is the same thing we did for 10 year term. Take the one year term costs over 20 years and take the average premium over those 20 years– and pay that average every year. That gives us level premiums for 20 years. This type of life insurance policy is called a 20 year term.

Definition of Term Life Insurance

We can extend this averaging process out over whatever time period we like – 8 years, 14 years, or 30 years. This generates a whole class of life insurance policies called Term Life Insurance.

Definition: Term life insurance is a policy that has level coverage and level premiums for a predetermined period of time.

Permanent Life Insurance

We've seen that with term life insurance we took one year term and simply averaged the costs out over defined periods of time – 10 years, 20 years, 30 years, etc. Lets extend that averaging out over our entire lifetime. In doing so, we end up with life insurance that has level premiums for life.

Definition: Permanent life insurance is a policy that has level premiums for life.

I'll point out again that we are not considering policies that are not guaranteed, or policies where there are investment options that are being used. Doing so leaves us with only two categories of permanent life insurance.

Guaranteed Whole Life Insurance

Guaranteed Whole Life Insurance has premiums and coverage that are level for life. It also has one other benefit. In the event that you cancel early, there's a refund of some of your earlier premiums. The refund is called a Cash Surrender Value.

Definition: Guaranteed Whole Life Insurance has level premiums for life, and a cash surrender value if you cancel the policy early.

Universal Life Insurance

Universal life insurance has two primary variations based on the insurance cost. One variation has level cost of insurance for life (known as T100 COI). Both variations have an optional investment component that we ignore for our purposes (because the investments are poor choices generally, and they lead to premiums and coverage that aren't guaranteed).

Definition: Universal Life Insurance with T100 COI has level premiums for life, guaranteed, with optional investments.

With this definition, Universal Life Insurance is a perfectly fine insurance type if you want insurance for life. This policy does have optional investments, but they are optional and you shouldn't use that option. As an example, I have a Universal Life insurance policy with T100 COI that I've had for many years. There's currently an investment value of 10 cents in the policy, due to rounding calculations over time.

Warning: *There's a second type of Universal Life Insurance, one that has increasing insurance costs and is called YRT COI. Do not buy YRT COI universal life.*

The Best Type of Life Insurance

Definition: The best type of life insurance is the cheapest insurance, over the time period that you need it for.

Well that seems easy! We only need to figure out how long we need the life insurance for, then determine the cheapest policy over that timeframe.

It turns out that we already know how long we need the life insurance for – we looked at this when we calculated how much insurance we needed. If you recall, we looked at protecting our income until retirement. After retirement, we aren't earning an income so we can't insure it. So, to start, determine the number of years between now and when you expect to retire.

But what's the least expensive over that period? The answer is, a term life insurance policy that closely matches your timeframe until retirement. If you recall how we constructed our different policy types, we averaged out the cost of the One Year Term over different periods. So over 10 years, a 10 year term will be cheaper than a 20 year term. Over 20 years, a 20 year term will be cheaper than a 30 year term. We now have a timeframe, and the cheapest over that timeframe so we can update our definition.

Definition: The best type of life insurance is a renewable and convertible term life insurance policy that has a term as long as your timeframe to retirement.

Since we are only seeking coverage until we retire, we have an end date to the coverage – and that means that permanent life insurance is not the appropriate coverage. We should be looking at term life insurance instead.

Market Conditions

In Canada, not all term lengths are equally competitive. Currently 10 year term, 20 year term, and 30 year term life insurance policies are extremely competitively priced, whereas other terms are less competitive. As a result, once you've determined the technically correct 'term', most consumers will then actually purchase whatever 10,20 or 30 year term policy matches closest to the 'technically correct' duration.

Now that you have an understanding of how much coverage you need and the best type of life insurance, you're ready to start running quotes. However there's two more things you should be considering in your calculation: term life insurance policy options, and underwriting types. We cover these two things in the next chapters.

Lastly, at this point you'll be comparing premiums to your budget. In my experience, the right amount and the right type of term life insurance is generally affordable. However in the rare instance that those premiums are not within budget then we need to cut something. What to do? Most consumers will immediately quote less coverage. This is the wrong solution. Instead, you should drop to a lower term to reduce premium. Reducing coverage amounts guarantees that if you pass away then your family doesn't have enough money to maintain their standard of living. That doesn't meet our goal. If instead you drop to a lower term we are in fact meeting our goal immediately. Yes, you'll still need to increase your budget at some point (and use the exchange option below) or risk a new policy at the end of the term. It's not a perfect solution, but it's better than locking in insufficient coverage.

Term Life Insurance Options & Benefits

In this section we're going to cover term life insurance benefits, options, and a few important policy provisions.

Free Benefits

The following four benefits are available on some term life insurance policies. Importantly, when they're available, they're available for free. And surprisingly, their availability is not tied to the cost of premiums. This means that policies with these four benefits are often just as inexpensive as policies without these benefits – you can't tell by looking at the premiums. Therefore you should ensure that when you're shopping premiums, that your comparing polices that have these benefits.

Renewable and Convertible

Renewable and Convertible (R&C) are two separate benefits, but since they're always found together we'll treat them as such. These two benefits are the most important benefits your term life insurance policy can have. And they're so important that you should NEVER purchase a term life insurance policy that lacks these features unless you have no other choice. Keep in mind that renewable and convertible term life insurance policies are as inexpensive as term policies that don't have these features.

Warning: Only purchase a term life insurance policy that is Renewable and Convertible.

A term policy has level premiums for a timeframe – lets say 20 years. In the life insurance types section, we said that at the end of the term, the coverage remains in force but the premiums revert back to the one year term costs. This switch at the end of the term is what makes a term policy renewable. By contrast if a policy is not renewable, at the end of the 20 year term your coverage is over – it's a hard stop.

Definition: Renewable term polices continue their coverage at the end of the first term, at a higher premium.

Conversion, or convertible term, is an interesting (and it turns out, very useful) benefit. The conversion benefit says that up to a specific age, generally 65 or 70, you can exchange your term policy for a permanent, lifetime policy. AND you can do this exchange without any medical questions. AND they'll issue you the new permanent policy at the health class from your original term policy – likely healthy.

In practice, that means if you get regular or standard premiums when you purchase your term policy and then later become completely uninsurable, you can simply switch your term policy for a permanent policy with no questions asked, and they'll give you the new policy at standard premiums.

Definition: The conversion benefit allows you to exchange your term policy for a permanent life insurance policy while using your health class from the original term policy. This means you can get a permanent life insurance policy with premiums at your original health class, even if you've become uninsurable.

Why R&C Term Is A Must Have

R&C term is often called insurance for your life insurance. That's because these two provisions protect us from some bad things that can happen during the course of our term. With these two benefits, if we suffer the results of some catastrophic risk we're protected. Without these benefits if we suffer the results of that risk, we're not protected and have no way to recover.

When we purchase a term life insurance policy, the assumption is that we need the life insurance coverage for a certain number of years, and at the end of that period we'll cancel it. That's at the start of your life insurance coverage – everyone's passed a medical exam, and has an end date in mind. Everyone's in the same group.

By the end of the term – 20 or 30 years from now,- we've split into three groups. Group one has passed away and received their death benefit. Group 2 arrives at the end of the term healthy and without any further need for life insurance so they cancel their policy -exactly as intended.

But there's a third group. Those are the people that have become uninsurable during the last 20 or 30 years. Is that you? Well, it's a random event that we saw earlier. It can happen, and it can happen to you, so we should plan for it.

If your policy is not renewable and convertible, at the end of the term your life insurance policy ends. And if you're in group 3, you're uninsurable so you're not getting any more coverage.

EXCEPT if your term policy is renewable and convertible. If you end up at the end of the term completely uninsurable, you can keep the coverage in force for a month or two (it renews) and then make the decision to convert your policy. Again, you're completely uninsurable, but you can exchange the term policy for permanent lifetime coverage, at healthy rates (because the company uses your insurability from 20 or 30 years ago when you bought the term) – no questions asked!

Hopefully you can see how important these two benefits are now. We don't know if you'll be in that third group, but if you are, R&C term will become the most important feature of your term policy all those years in the future. These benefits make the difference between "you're uninsurable, and there's no more life insurance" to "you're uninsurable, but can get a new policy for the rest of your life, AND at healthy, affordable premiums".

And as I noted above, R&C term policies are every bit as inexpensive as policies without these benefits.

Accelerated Death Benefits

This is another benefit that is embedded in some term policies at no charge. With this benefit, if you have limited mortality, generally less than a year, you can access a portion of your death benefit while still alive. Funds paid out in this fashion are then treated as a loan against your death benefit.

Exchange Option

The exchange option is similiar to the conversion option. Conversion lets you exchange your term policy for a permanent policy. Similiarly, the exchange option lets you exchange your term policy for a longer term policy, again without a medical exam. For example, with this benefit you can jump from a 10 year term to a 20 year term.

The exchange option is only available after the first year of your policy, and only for the first five years.

When would we use this? In some cases we want a longer term, but want a cheaper, shorter term policy to start. With the exchange option you can purchase a 10 year term, and then within the first 5 years, bump up to a 20 year term. Three common situations where this is beneficial: First if you have a rating that could be temporary, such as weight. Take the cheaper term 10, reduce your weight to remove the rating, then use the exchange option to go to a 20 year term (now unrated). Smoking works the same way – you can purchase a less expensive term 10 policy at smoker premiums. Quite smoking and requalify at nonsmoking premiums, then bump up to the 20 year term at nonsmoking premiums. And lastly, for budget reasons – if you want 20 year term but don't want to pay the premiums initially you can go with a 10 year term (which is cheaper), then jump to the 20 year term later.

Riders – Optional Benefits

Riders are add on options that have a small incremental cost to them.

Accidental Death Benefit (ADB)

ADB pays an additional death benefit if you die as the result of an accident, as opposed to say medically.

Recall when we figured out how much life insurance we needed that the amount had nothing to do with how we died. We don't need $1,000,000 if we die from a heart attack, but $1,200,000 if we die in a car accident. We either need $1,000,000 in both cases, or $1,200,000 in both cases. Therefore, skip this rider.

Disability Waiver of Premium (WP)

If you become completely disabled, after about 6-9 months of disability, the WP rider will pay the cost of your premiums on your life insurance policy.

What you should have instead is a full featured long term disability policy that covers your income and allows you to pay all your costs, not just your life insurance premiums. Therefore, make sure you have proper long term disability coverage, and skip this rider.

Children's Protection Rider (CPR)

CPR provides a small amount of life insurance for all of your children at a fairly inexpensive premium. An example would be a rider that covers all your children for $20,000, at a cost of $10/month.

When the children become adults, the rider allows you to carve off their coverage and obtain their own policy for some multiple of the original $20,000.

CPR is between no coverage on your children, and their own policy. Life insurance on children is beyond the scope of this ebook so I'll summarize it. If you want a small amount of life insurance on your children, CPR is an inexpensive way to obtain coverage.

Policy Provisions

The following two provisions are in all term life insurance policies. They're the two 'loopholes' that allow a life insurance company to deny a claim. Being aware of them allows us to close the loopholes, and results in a rock-solid life insurance policy that has to pay the claim.

Suicide Exclusion Clause

This clause says that if you pass by suicide in the first two years of the life insurance policy, that the company can (and will) deny your claim.

Incontestibility

This clause is the biggest loophole that you can close. Technically the clause says that the company can deny a claim in the first two years due to lack of information, and after that, only due to fraud.

In practice, life insurance companies will sometimes deny claims at any time, due to failure to disclose information. And it doesn't matter if what you failed to disclose was related to how you died. It doesn't matter if you failed to disclose something because you thought it was inconsequential. And it absolutely doesn't matter if you did it deliberately, maliciously, or fraudulently. The insurance company doesn't have to prove fraud, they simply deny the claim.

The incontestibility clause is the biggest loophole in a life insurance policy. The good news is, in the Medical Exam section I'm going to show you how to slam the door shut on this loophole, ensuring that the life insurance company has to pay the claim.

No Medical Exam & Underwriting

Consumers tend to assume that life insurance companies and underwriters (the people who review your medical history and determine which premium class you qualify for) want to penalize you or deny you coverage. In fact, it's exactly the opposite. They want to sell you their life insurance. And they do that by giving you the cheapest possible rates for the policy that you've chosen, that you qualify for.

Underwriters do this by reviewing your medical history for each risk factor and trying to eliminate each factor from consideration. If they have enough information, they can discard a risk factor. With insufficient information, they're unable to discard the risk and need to charge appropriate premiums. Here's two possible answers from the same person: "I have high blood pressure" and "I have high blood pressure. I take medication for it, here's the dosage. My blood pressure is fully controlled and within normal bounds. I see my doctor once a year for an update. Here's my last two years of readings."

In the first case, that's quite possibly a denial of coverage. In the second case it's quite possibly standard or 'healthy' premiums. Same person, but in the second case the underwriter was able to eliminate the risk from consideration.

More on this in the next section when we look at medical exams.

No Medical Exam Policies

When consumers hear 'no medical exam' they often think everyone qualifies – there's no health consideration. Back in the 1980's these policies existed and were called guaranteed issue policies. Everyone who paid premiums received coverage.

These policies covered everyone, even the uninsurable. As a result they had some obvious drawbacks including:

- Maximum coverage around $25,000.
- No real death benefit coverage in the first two years.
- Extremely high premiums.

Simplified Issue Policies

Fast forward a couple of decades, and the industry introduced policies that weren't guaranteed issue, but weren't reviewed by an underwriter. These policies have a few medical questions that you answer yes/no to. If you answer them all no, you qualify for the coverage. If you answer even one yes, then you don't qualify.

Like guaranteed issue, these policies allow for a lot of 'less than insurable' people to qualify. And that means that premiums are high, generally twice the premium of a policy that's reviewed by an underwriter. It's fast and easy to apply, but these policies come with substantial drawbacks including:

- Higher premiums. Healthy people are getting the same coverage as people who have insurability issues but have self-selected by reviewing the questions and finding a policy that doesn't ask about their specific condition.
- Limited benefits. Some of these policies limit death benefits in the first two years, or chop out important policy features such as renewable and convertible term.
- Increased possibility of claim denial. With these policies you are doing the underwriting – you're deciding if you qualify by reading and interpreting the questions. The life insurance company reviews your application upon your death and finds a different interpretation to your answers – they decide that one of the questions should have been Yes. At this point they'll deny the claim. Most experienced advisors have seen situations where the answers seem straightforward, but in fact the life insurance company has a different interpretation of the question than the consumer – in other words, a highly probable claim denial. Remember the incontestibility (LINK) loophole I mentioned above? That's how it can be used, mistakenly answering a question in a way that differs from the way a life insurance company interprets it, even unintentionally, and the incontestibility clause (and thus a claim denial) will be invoked.

Variations of these simplified issue policies are now appearing in the marketplace. But since consumers tend to heavily shop on price, and these policies are by default about twice the price of a typical renewable and convertible term policy, these products limit benefits in order to make them price-competitive. The benefits that are getting chopped are often the renewable and convertible part. Renewable and convertible benefits tend to be very important at the end of a term policy instead of the beginning, most consumers aren't even aware that they may be giving up these important policy provisions in exchange for a faster time to policy issue. **Buyer beware.**

Fully Underwritten Policies

Covid changed the medical underwriting procedures in the industry. Currently a typically fully underwritten, or 'medical exam' policy consists of a minimum of two parts and sometimes three.

Application Paperwork

The first part is the application. This consists of your signature and basic data like address and occupation. This is required for all applications.

Telephone Interview

The second part is a telephone interview where your medical history is collected. Again, these policies are occasionally marketed as ‘no medical exam’ policies. Are they? Well, they’re fully underwritten so.....you’ll have to make up your own mind on the use of the term.

The telephone interview is roughly a 20 minute phone call. It’s not an exam, its just collection of data.

Blood and Urine Sample

The last part that happens only for older ages and higher face amounts, is a blood and urine sample. When required, this is the only part that’s done in person. A paramedical person will book an appointment to come to your home. They’ll have you pee in a cup, and collect a few small vials of blood. Total in person time, about 10 minutes.

Summary

Fully underwritten policies typically have ‘everything’ in terms of benefits You should have all available free policy benefits like renewable, convertible, accelerated death benefits and the exchange option. Premiums, including these benefits, should be the lowest premium of any type of life insurance.

You should be aware and understand that if you’re going with some variation of less underwriting (or more towards ‘no medical exam’) that you’re either trading off higher premiums, or more likely in today’s online environment, important policy features that are likely to become very important if you become uninsurable by the end of the term.

How To Take A Medical Exam

As we saw above, a medical exam policy isn’t an exam. It’s a phone interview that collects your medical data and occasionally also a blood and urine sample. There’s no exam component, there’s no pass or fail and there’s no ‘test’ where you have to run on a treadmill (except for very large coverage amounts where they may request a stress test, and then sure, you may have to run on a treadmill!).

So, the underwriting is mostly just data. During the course of the phone call you'll simply tell them about your entire medical history, to the best of your ability and recollection. You don't have to prepare for it, if you don't know an answer, be clear and tell them that you don't know.

However there are some things we can do during the telephone call that are to our benefit – they can result in lower premiums, and better coverage.

Recall that underwriters are looking to eliminate risk. To do so, they need information. Without enough information, they have to retain the risk in your profile. With enough information, they can determine that what looks like a risk, doesn't actually impact your mortality. So, number one biggest thing is:

When answering questions during your medical history phone call, be complete. Provide as much information as you can even if you feel it's not relevant or inconsequential. If you are disclosing a condition, describe at least 5 things: Symptoms, tests, diagnosis, treatment, and results.

It's important to listen to the questions carefully, and answer them as asked. Here's two contrasting answers to the same question.

Q: Have you ever had any tests, investigations, injury, treatment or surgery on your eyes?

Wrong Answer: No, my eyes are fine.

Correct Answer: Yes. I have my eyes tested every two years, otherwise my eyes are fine. Or, I have my eyes tested every two years and wear corrective lenses or glasses.

I appreciate this seems a bit onerous. It's not. We get two huge benefits to our life insurance policies when we take the time to answer in this level of detail.

Huge Benefit #1: Potentially cheaper premiums! Underwriters sometimes have to make a decision on whether to charge you higher premiums or not – sometimes a condition is right on the edge. Underwriters are risk adverse and by default will assign you the higher premium if they can't discard the risk. However, if they are fully confident that there's nothing outstanding, nothing hidden, and nothing overlooked, then they can and frequently will make the decision to give you cheaper premiums. If the underwriter is content that 'they know you' medically, they'll give us better premiums whenever they can.

Huge Benefit #2: The company can't deny your claim. Recall there were two ways a company can deny a claim – suicide in the first two years, and failure to disclose information (incontestibility clause). If you've answered in this level of detail not only is there no opportunity for the life insurance company to claim failure to disclose, it will be readily obvious to them that they can't deny your claim. And in those cases, they will generally pay out any death claims in a matter of just a few days after the paperwork is filed.

While we can appreciate that consumers tend towards not wanting to bother with this level of detail, it's important to overcome your natural inclination towards privacy, and remove your concerns that a life insurance company is seeking to charge you higher premiums. Go through your telephone call at this level of detail and you can rest assured that you have the cheapest premiums available to you, and should you die, that your policy is rock solid and your claim can't be denied.

Congratulations on making it all the way through! You're now well educated and armed with what you need to know to purchase a life insurance policy. You know how to determine how much, the type, you know the important policy benefits and features, and you know the different policies by underwriting type. You're ready to proceed with confidently purchasing life insurance. But, in the event that I've failed to cover anything, or if you have any questions at all, feel welcome to reach out to me at (866) 779-1499.