FTC's draft
of
LIFE INSURANCE BUYER'S GUIDE

IMPORTANT: Most people think all life insurance policies cost about the same. They don't. Reading this Buyer's Guide can save you many hundreds of dollars over a twenty-year period by helping you find a low-cost policy that best fits your needs.

TWO TYPES OF INSURANCE

There are two basic types of life insurance: term and whole life. Both pay money-- the policy's face amount or death benefit -- to your family when you die. They differ in that term insurance provides only death protection, while whole life insurance combines death protection with a savings program. Another important difference is in the premiums. Term premiums are at first quite low, but go up each time you renew your policy. Whole life premiums are at first much higher than those for the same amount of term insurance, but stay level as long as you keep the policy in force.

Whole life insurance is a lifetime contract, while term insurance is sold for a fixed number of years, usually one, five, or ten. Many term policies, however, are guaranteed renewable until you're 65 or older. This means that each time your term policy is about to expire, you can renew it for another term without having to worry about passing a medical exam. With each renewal your premium will go up. It's a slow process, though. If you buy a renewable term policy at age 35, it will take about 20 years until the premium for your renewable term policy will be higher than the level premium you would have paid if you had bought a whole life policy. Beyond age 65, term premiums become very expensive. But by then you may want to drop your policy anyway. The point to remember is that a renewable term policy, and not just a whole life policy, can meet your long-term insurance needs, at least through age 65.

HOW MUCH TO BUY

Before deciding between term and whole life insurance, you should first ask yourself why you need life insurance. The main reason for buying life insurance is to help your family keep up a decent standard of living if your early death deprives them of your earnings. How much insurance should you buy? Enough to cover the difference between the amount of money your family will need if you die and the amount they'll actually have. If you're covered by Social Security, don't forget to include the monthly check your family will get from the government in figuring how much insurance you'll need.

TERM OR WHOLE LIFE

When you're young and your insurance needs are generally greatest, term insurance gives you three to five times more death protection for your premium dollar than whole life. Many people, especially those with young children, can only afford the amount of insurance they need by buying term insurance. Therefore, if you're interested in getting the most death protection for your money, you should buy term insurance.

Most people find that their need for death protection drops as they get older and their children grow up and leave home. Still, many people want some insurance in force during their retirement years. Insurance after 65 serves a different purpose than protection against the loss of your earnings. After 65 insurance is mainly used to pay for funeral expenses, medical bills, and death taxes. It can also provide money for the surviving members of your family. Buying a whole life policy is one way to make sure that money for these purposes will be available during your retirement years.

SAVING THROUGH WHOLE LIFE INSURANCE

There's a simple reason why a whole life policy can make insurance affordable beyond age 65. The premium for a whole life policy stays the same throughout your life. During the early years of your policy you pay much more than the amount needed to buy death protection for a person your age. Most of the difference goes into the policy's savings element, called the cash value, which grows steadily over the years. When you die, the insurance company will use this cash value to help pay the policy's death benefit. For example, if you buy a $10,000 whole life policy at age 35, it will have a cash value of about $5,500 by the time you're 65.

If you die at 65, your family will get $10,000. Of that amount, $5,500 will come from the cash value you've built up. The insurance company will only have to come up with an additional $4,500 to pay the $10,000 death benefit. If you live beyond 65, your cash value will continue to grow. At the same time, the amount the company will have to come up with to pay the death benefit will continue to decrease. Thus, a whole life policy permits you to afford insurance beyond 65 because your level premium buys less and less death protection as time goes on.

Besides making it possible to have life insurance beyond age 65, cash values can be useful to you in other ways. Many people find buying a whole life policy a convenient way to save for retirement or other purposes. Each time you pay your premium, a part of the premium automatically goes to build up the policy's cash value. You can get the full amount of the cash value by canceling the policy. But if you do, you'll lose your death protection. You can also borrow up to the full amount of the cash value in the form of a policy loan. But if you do that, you'll have to pay interest to the insurance company at the rate fixed in the policy. Finally, if you die with your whole life policy in force, your family gets only the policy's death benefits (less any unpaid loans), <u>not</u> the death benefit plus the cash value.

TWO WAYS TO SAVE

If you want death protection for your family while you're young and a source of money for use after you're 65, there are two things you can do. You can buy a whole life policy with its built-in savings program. Or you can buy a term policy and each year invest the difference between the whole life and the term premium in a savings account, U.S. savings bonds, or some other safe investment. If you're the kind of person who can save regularly, you'll build up a sizable sum of money by the time you're 65. You can then use this sum for the same purposes as the cash value of a whole life policy. This may greatly reduce or even end your need for life insurance in your later years.

To find out whether you can save more by buying a particular whole life policy or by buying a term policy and investing the difference, look at the whole life policy's Average Annual Rate of Return. This rate is figured by treating part of your premium as payment for relatively inexpensive death protection and the remainder as a savings "deposit." The rate of return is then the interest rate that would build up these deposits to equal the cash value guaranteed in the policy. You'll find the Annual Rate of Return if you keep the policy for 5, 10 and 20 years on the Consumer Cost Statement an agent must give you with each policy you're shown. You should compare this rate of return with the interest rate you could earn on a savings account or other safe investment. But remember to take taxes into account. Interest earned on the savings element of your whole life policy is usually not taxed, while the return on most other investments is. So be sure to compare the Annual Rate of Return on a whole life policy with the after-tax return on other safe investments. If the whole life policy's rate of return is lower than what you could get elsewhere, you'd probably do better buying a term policy and investing the difference.

A WORD OF CAUTION BEFORE BUYING WHOLE LIFE

Don't buy a whole life policy unless you're sure it's the type of policy you want. It's a costly mistake to buy a whole life policy only to drop it after a year or two. If you do, you'll usually get next to nothing back. It's true that few people plan to drop their whole life policies soon after buying them. Yet about one in five new policyholders actually does just that. Moreover, you shouldn't buy a whole life policy unless you plan to keep it at least ten years. The cash value of a whole life policy builds up very slowly during the policy's early years, making whole life insurance a very uneconomical way to save for short-term needs.

COMBINING TERM AND WHOLE LIFE

If you think you'll want some insurance in force after 65 but can't afford enough whole life insurance to give your family adequate protection while you're young, there are several things you can do. One is to buy a renewable term policy that's also convertible. You can trade in such a policy at any time for a whole life policy of the same or lesser face amount without having to pass a medical exam. People with young children often find this type of policy attractive because it lets them buy a large amount of death protection when they're young at a price they can afford. At the same time they preserve their option to buy a whole life policy later if they decide they want some insurance in force after age 65. Another thing you can do is buy a combination of term and whole life insurance. You can do this by buying separate policies. Or you can buy a whole life policy with a term policy attached to it. (This is called a term rider.) In either case you'll get insurance that can remain in force past 65 along with some additional death protection for your younger years when you need it most.

"PAR" OR "NON-PAR" POLICIES

Some term and whole life policies are designed to pay dividends (participating or "par" policies), while others aren't (non-participating or "non-par" policies). Dividend-paying policies generally have higher premiums than non-dividend-paying policies, but often cost less in the long run, especially if their dividends are paid year after year. The dividend amounts a company expects to pay each year are known as "illustrated" dividends. These illustrated dividends are not guaranteed. The exact amount a company actually decides to pay in dividends each year depends upon a number of factors, including the company's investment income for that year. These factors simply can't be predicted with complete accuracy several years in advance. In recent years, however, the actual dividends paid on most "par" policies have been higher than those illustrated at the time the policies were sold.

GROUP INSURANCE

Before you buy an individual life insurance policy, check with your employer, labor union, or professional association on your eligibility for group term insurance. Group insurance often costs much less than either individual term or individual whole life, especially if your employer pays part of the premiums. In addition, you can usually buy group insurance without passing a medical exam. Like individual term insurance, however, group insurance is usually renewable only through age 65 or 70. There may also be a limit on the amount of group insurance you'll be able to buy. If you switch employers or drop your union or professional association membership, your group coverage may end. But if that happens, you're guaranteed the right to convert that coverage to an individual whole life policy (at a higher premimum). All things considered, group insurance can provide a solid, relatively inexpensive foundation for your personal insurance program.

HOW TO FIND A LOW-COST POLICY

Once you've decided on the type and size of policy you want, use the Consumer Cost Index to find a low-cost policy. It's on the cost statement that comes with each policy you're shown. Don't just pick a policy with a low premium. Premiums only measure what you pay for a policy. They don't measure a policy's benefits. Those benefits, which may include cash values and dividends as well as death protection, vary by large amounts among policies with similar premiums sold by different companies. The Consumer Cost Index takes premiums, cash values, and dividends into consideration and is a measure of the difference between what you pay for a policy and what you or your family gets back. Remember: the lower the Consumer Cost Index, the lower the policy's cost to you.

> IMPORTANT: Most people think all policies cost about the same. They don't. The cost of similar policies varies sharply. To tell at a glance whether a particular policy has a low Consumer Cost Index, look at the chart attached to the policy's consumer cost statement.

In using the Consumer Cost Index, remember three things. First, the index is only approximate. So, rather than searching for <u>the</u> lowest-cost policy on the market, use the index to find a <u>group</u> of relatively low-cost policies from which to make your final choice. Second, the Consumer Cost Index is only useful in comparing the costs of <u>similar</u> policies. <u>Don't</u> use it to compare the cost of a term policy to that of a whole life policy. Instead, base your choice of term versus whole life on factors mentioned earlier in this Buyer's Guide. Third, the Consumer Cost Index for a dividend-paying policy assumes that dividends on the policy will be paid exactly as illustrated at the time the policy was issued. This, however, rarely happens. Since the exact amount of a "par" policy's dividends isn't guaranteed, the policy's actual cost may turn out to be higher or lower than that indicated by the Consumer Cost Index. In recent years, however, the actual dividends paid on most "par" policies have been higher than those illustrated at the time the policies were sold. As long as you recognize this uncertainty, you can use the Consumer Cost Index to compare the costs of dividend-paying and non-dividend-paying policies.

OTHER TYPES OF POLICIES

In addition to whole life policies, there are many other policies on the market with savings elements. The most common of these are "life paid up at 65," "20-pay life," and endowment policies. "Life paid up at 65" and "20-pay life" are policies in which you pay premiums over a limited period instead of over the entire life of the policy. Endowments are policies in which the cash value equals the policy's face amount at the end of a limited period, usually 20 or 30 years. Each of these policies have higher premiums than simple whole life policies. They may be useful for certain special needs. But most people's insurance needs can be met by either term or whole life insurance or a combination of the two.

AGENTS

A final word about agents. You'll probably buy your life insurance through an agent. An honest, well-informed agent can help you find a low-cost policy that fits your needs. But a life insurance agent is also a salesman who's paid on a commission basis. Typically that commission is based on a percentage of your yearly premium. Thus, for the same amount of insurance, an agent will get a higher commission for selling whole life than for selling term because the whole life policy's premium are higher. In addition, many agents get a higher percentage commission for selling whole life than for selling term. Finally, not all agents are well-informed, not all policies are competitively priced, and not all agents are free to offer you choices that are in your best interests because they may represent only one high-cost company. Read this Buyer's Guide carefully, along with the Consumer Cost Statement that comes with each policy you're shown. If you do, you should be able to make better use of a good agent's services. And you'll be more likely to find a low-cost policy that best fits your needs.

REMEMBER: Be sure to shop carefully before buying life insurance. And always look for a policy with a low Consumer Cost Index.