PRINCIPLES OF RISK MANAGEMENT AND INSURANCE

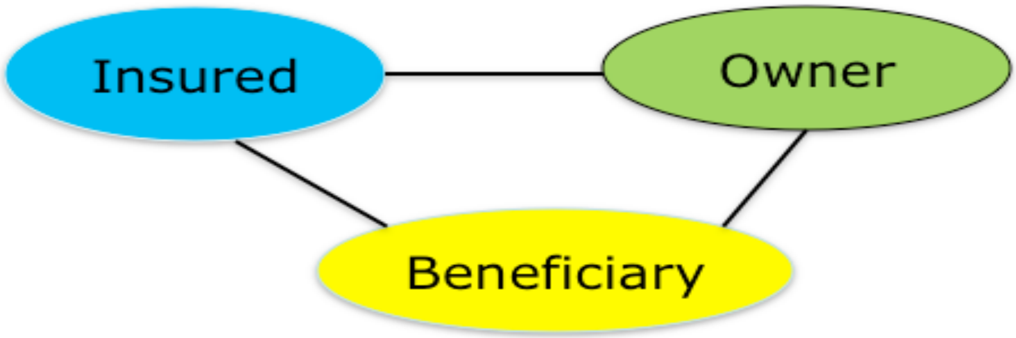
CLASS NOTES

Chapter 17 Life Insurance Contractual Provisions

Topics

- Life Insurance Contractual Provisions
- Additional Life Insurance Benefits

Three Parties of Life Insurance Contract



- One person may be both insured and owner, or owner and beneficiary but a person cannot be both insured and beneficiary.

Example:

- ✓ You buy life insurance for yourself (both owner and insured are one person).
- ✓ You buy a life insurance for your husband/wife

(Both owner and beneficiary are one person).

- ✓ If you are insured and anything happens to you, you can not be the beneficiary of your own life insurance (beneficiary and insured can no be the same person).

Life Insurance Contractual Provisions

- Under the ownership clause, the policyowner possesses all contractual rights in the policy while the insured is living
  - Rights include naming beneficiaries and surrendering the policy for its cash value
  - The policyholder can **designate** a new owner by filing an appropriate form

Revocable Beneficiary Vs. Irrevocable Beneficiary

Revocable Beneficiary

If the owner has the right to change the beneficiary after the first choice .The revocable beneficiary has no rights in the policy while the insured in alive.

Irrevocable Beneficiary

If the owner cannot change the name of beneficiary. The irrevocable beneficiary has a vested interest in the death benefit and can prevent the owner from taking any action reducing the beneficiary's interest.

Beneficiary Designation

Owner's of a policy should identify the beneficiary clearly.

A designation such as "my wife" or "my children" can lead to litigation in cases of multiple marriages, children born of different marriages , or illegitimate children.

"my wife, Marie Antoinette," or, "all the children born of my marriage to Marie Antoinette, share and share alike."

Primary and contingent beneficiaries

If the first beneficiary predeceases the insured the second, third, etc. are entitled to receive the death benefit.

Example of beneficiary designation

" Proceeds to my wife (Cathy T.Gate). If my wife predeceases me , then to my children(Tom, Dick, and Harry Grate) – share and share alike .If both my wife and my children predecease me, then to American Red Cross."

The insurers can use the court system to resolve legal issues when there is frequent beneficiary changes or unclear beneficiary designations. This is called "interpleader".

Example: Cases of ambiguity such as terrorist attack of September 11,2001, or Hurricane Katrina where the order of death, or even the fact of death of a missing person might arise.

Contractual Provisions in Life Insurance

- The law requires that approved policies satisfy at least the minimum provisions of the law. The format and wording of life insurance policies sold in New York by different insurers may differ from one another. However, the following provisions appear in life insurance contracts issued in New York:

1- Entire-contract provision
2- Incontestable clause
3- Suicide clause
4- Grace period
5- Reinstatement clause
6- Misstatement-of–age provision

Dividend Options

- If a policy pays dividends it is a participating policy
  - Otherwise it is a nonparticipating policy

Life Insurance Contractual Provisions

- The entire-contract clause states that the life insurance policy and attached application constitute the entire contract between the parties
  - Prevents the insurer from making amendments without the policyholder's knowledge

- The incontestable clause states that the insurer cannot contest the policy after it has been in force two years during the insured's lifetime
  - Protects the beneficiary if the insurer tries to deny payment of the claim years after the policy was first issued
  - The insurer has two years to detect fraud
- The suicide clause states that if the insured commits suicide within two years after the policy is issued, the face amount of insurance will not be paid; there is only a refund of the premiums paid.
- A life insurance policy contains a grace period during which the policyholder has a period of 31 days to pay an overdue premium.

Grace period

If the insured forgets to pay the premium or decides to end the contract, the **grace period** provides him or her a period of 31 days to pay the premium without forfeiting any contractual rights.

- If the policyholder dies during the grace period , the insurer will pay the proceeds , minus the overdue to the beneficiary.
- If the policyholder dose not pay the premium before the end of the 31 days provided by the grace period;however,the policy is said to have lapsed.
- What is a lapsed policy?

In a lapsed policy the insured voluntarily has given up the life insurance contract.

- When insureds let a policy lapse, it means they have become displeased with their purchase or perhaps cannot afford to pay the premium.

Life Insurance Contractual Provisions

- The reinstatement provision permits the owner to reinstate a lapsed policy
- To reinstate a lapsed policy, the following requirements must be met:
  - Evidence of insurability is required
  - All overdue premiums plus interest are paid
  - Any policy loans are repaid or reinstated
  - The policy was not surrendered for its cash value
- The policy must be reinstated within a certain period
- Although it may require a large outlay of cash, it may be cheaper to reinstate a lapsed policy than to purchase a new policy

Misstatement-of-age Provision

- Age is a key factor in underwriting and pricing the insurance.

- Misstatement of age either intentionally or by mistake, causes rating errors.
- Misstatement-of-age provision allows the insurer to adjust the face amount of insurance to reflect the insured's true age, rather than allowing the insurer to void a policy if a misstatement is discovered.

Example: If the age of insured is reported to be three years less than it actually was, the benefits would reduced from $100,000 to $92,000 or whatever amount of insurance would purchase at the insured 's true age.

Additional Life Insurance Benefits

- Other benefits can be added to a life insurance policy for an additional premium
- Under a waiver-of-premium provision, if the insured becomes totally disabled, all premiums coming due during the period of disability are waived
- The accidental death benefit rider doubles the face amount of life insurance if death occurs as a result of an accident
- The accelerated death benefits rider allows insureds who are terminally ill to collect part or all of their life insurance benefits before they die

End of Chapter.