



Financial Advisory Services

Simplifying the Complexities of Life Insurance

We've all been there at one time or another – pondering the benefits of life insurance. Do we need more? Can we make do with less? Do we need any at all? Term, whole life, universal or variable?

Insurance is probably the first serious financial question most of us address as adults starting new families and entering the work world. As the stakes get higher with each passing year, life insurance can serve as a margin of safety for you and your family, and also

as a versatile financial tool in building long-term wealth in your estate.

Insurance can play a critical role in any well-conceived financial and estate plan. But because insurance comes in so many different and confusing forms, it takes serious expertise to gain an understanding of what's right for you and your family. This issue of the *Financial Advisory Services* newsletter will answer many of the questions that have perplexed you about insurance, and prepare you to ask the questions that will help you evaluate the role of insurance in your financial plan.



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SPECIAL POINTS OF INTEREST

- A basic understanding of life insurance will help you analyze the features and benefits your policy provides.
- Underwriting is the time for the educated consumer and the quality advisor to team up and be sure the insurance company is offering the best price structure possible.
- How much insurance you **“need”** depends upon what you expect insurance to **“do”**.

Types of Life Insurance

How many types of life insurance can you name?

Ready...GO!

Most of us can rattle off two within seconds: **Term and whole life**. Many people can get up to three or four including **universal life and variable life**. A seasoned insurance salesperson could spend the better part of an hour listing a type of insurance for every letter of the alphabet from adjustable life to zero-premium exchange. A basic understanding of the broad categories of life insurance will help you to analyze what features and benefits your policy may provide. Virtually every policy will fall into one of these four categories:

TERM

The simplest and most common form of coverage is term insurance. As the name “term” implies, this coverage is meant to cover the insured for a specified length of time. Common term periods include 1 year, 10 years, 20 years, and even 30 years. Term insurance is pure insurance protection. You pay the premium and if you die, the death benefit is paid to your beneficiaries. Life insurance provided through your employer is most commonly one-year term.

There are a few twists to look for in your term coverage to better understand your specific policy:

- Premiums may increase every year or remain level -- annual renewable versus level term.
- Death benefits may decrease, increase or remain level: decreasing, increasing, and level term.
- You may also have an option to convert your term policy to a permanent policy without proving insurability. This can be a very valuable privilege and is often the most important variable, other than price, when choosing between term policies.

WHOLE LIFE

Simply put, whole life was originally designed to provide protection for the insured’s “whole life”. Many variations of whole life have emerged since its inception, but the fundamentals of this coverage remain the same:

- Protection to the insured’s age 100
- Level premium to age 100
- Guaranteed and non-guaranteed cash value accumulation

The premium for whole life insurance is much higher than term, but it is important to realize that premium and cost are not the same thing. A portion of the premium pays the cost of the policy and the excess is deposited in the policy’s reserve. This reserve earns a guaranteed interest rate and may also receive dividends based on the performance of the insurance company. The cash can be accessed by taking a loan against the policy that is paid back at the time of death. The many variations of whole life insurance rely on performance assumptions of the reserve account and dividends to increase and decrease both the death benefits and premiums required over the life of the policy.

UNIVERSAL

The word “universal” in the life insurance world signals a very important policy feature: flexible premium. In whole and term life policies, the policyholder is contractually obligated to pay a fixed premium at fixed points in the future. Failure to pay a premium is a breach of contract and will cause your policy to lapse. In universal life policies the cost of insurance is paid out of the cash value of the policy. As with whole life, premium and cost are often confused. The cost of insurance works much like an annual renewable term

policy. The owner of the policy is allowed (up to an IRS maximum) to put additional money, or additional premium, into the policy at any time. This excess is placed in the policy account and will earn an interest rate set forth by the carrier. The policy will have a guaranteed minimum interest rate as well as a current rate that is generally competitive with interest rates credited by other carriers. As long as there is enough money in the policy account to pay the cost of insurance every year the policy will stay in force. Surplus cash value can be withdrawn up to the total amount of premiums the owner has paid and excess “growth” can be accessed through loans. Withdrawals up to basis and loans are not taxable as long as the policy remains in force.

Types of Life Insurance *(continued from page 2)*

The owner may also select between two death benefit options. Option A (option 1) means that at death the beneficiaries receive only the death benefit outlined in the policy. Option B (option 2) pays out the death benefit and also the accumulated cash value. As you might imagine, the cost of the insurance in Option B is higher to account for the increased death benefits payable.

The increased flexibility in premiums, death benefit options, and the uncertainty of interest crediting rates make universal life a less predictable form of coverage, yet it is precisely this flexibility that provides its appeal.

VARIABLE

The word “variable” in life insurance means the cash value is invested in a separate pool of assets that work much like mutual funds. Variable can be attached to both whole life, variable whole life (VWL), and universal life, variable universal life (VUL). The required premium, length of protection, and death benefit amount are all ultimately tied to the performance of the separate accounts. The policy owner has a choice of what

separate accounts he/she would like to invest in and can change this allocation at any time (within contractual limits). Variable life insurance is considered to be the most unpredictable form of life insurance coverage. The potential for negative returns in the separate accounts could lead to early and unexpected lapse of coverage. Conversely, the potential for high returns can drastically reduce the total amount of premium required to provide the level of coverage that is desired by the policy owner. Because of the uncertainty associated with variable life, extra care should be given in the pre-purchase analysis of this type of coverage, as well as frequent and thorough post-purchase review.

Within these four broad categories there are literally hundreds of variations that bend the general rules outlined above. Insurance companies push the boundaries of the various policy types in order to improve the overall performance of every premium dollar that goes into an insurance policy. A basic understanding of the broad categories of life insurance will help you, as the consumer, understand what features and benefits your insurance provides.

Underwriting: How an Application Becomes a Policy

One of the least understood and least questioned aspects of life insurance is underwriting. Even some of the most educated insurance experts don't understand the process that takes place between the prospect saying “Yes” and the agent delivering the policy. Unfortunately for many policyholders, no one ever told them that this is a time to flex your buying muscle. This is the time that choosing the right broker, increased knowledge of insurance, using your connections, and good clean living can pay off.

Despite what any sales illustration says, you do not know how much your life insurance is going to cost until the underwriting is complete. Depending on the results of this phase in the insurance planning process, you may end up with the most competitively priced, well designed policy, or an overpriced mediocre plan that could be improved the month after it's put in place. Here are a few underwriting points to consider:

Underwriters are people

Your application will be sent through a processing center at an insurance company and at some point

end up on the desk of an individual that will make the ultimate decision on how much your insurance will cost. This person has general guidelines to follow regarding height/weight, cholesterol, blood pressure, but they have the freedom to look at the overall picture to come up with a risk classification. Ask your agent/broker to include a cover letter with your application that will introduce you to the underwriter. You want the underwriter to see you as a real person when they are looking at your file. There is a lot more there than your medical results.

How's your health?

Your health is considered in two ways during the underwriting process. You will be asked for a medical history and you will more than likely complete a paramedical exam. The paramedical exam is a simplified physical usually consisting of blood pressure check, blood and urine samples, and height/weight measurements.

There is not a lot you can do about your history: Be

Underwriting: How an Application Becomes a Policy *(continued from page 3)*

honest. Don't lie. Answer the questions as they are asked. If the question asks for "the last 5 years," no need to bring up a medical issue that ended 6 years ago.

The paramedical exam is under your control: Schedule your exam a few days out. Meet somewhere you are comfortable on a day you can be relaxed. Fast for at least eight hours before the exam. Do not eat a high salt/cholesterol dinner the night before. Do not engage in strenuous exercise for 24 hours before the exam. If you forget and eat Chinese buffet the night before and have a jelly donut and three cups of coffee the morning of your exam, reschedule. Those meals could end up costing you literally thousand of dollars in insurance premiums, so plan ahead and make good diet choices. It will make a difference.

Competition is a good thing

Insurance companies want to be in the insurance business. They are willing to pay commissions to agents and brokers who sell their policies because they want more policies sold. Millions of marketing dollars are spent to convince you to buy from them. If you are not satisfied with the product that is being offered at the end of the underwriting process, you do not have to accept it. Any insurance broker that is truly looking out for your best interest will "shop" the insurance around if you are not happy with the underwriting decision. This threat alone may be enough to get the underwriter to move you up a rate class. If not, another carrier may be willing to do so. Most times this requires you to fill out more paperwork, but you will not be required to retake any medical exams. The other option is to submit the case under "competitive underwriting." Fill out two or three applications for different carriers and submit them simultaneously. Be sure to let all the carriers know you have submitted under competitive underwriting. Compare the final costs, not the hypothetical costs you see in a sales illustration.

Challenge the Results

It is your right to request any medical results that were used in the underwriter's decision. Look the

results over and then double-check them with your doctor. If you always have cholesterol around 220 and your paramedical exam shows you have a count closer to 280, this will dramatically affect the cost of coverage. Many times the paramedic who takes your blood will not return to their office right away. This can lead to degeneration of red blood cells that will skew your results. Insurers know this and tests taken at your doctor's office will carry more weight and could possibly lead to a successful challenge of your rating.

The APS

"We are waiting on the APS." If your underwriting takes longer than 4-6 weeks and you wonder why, this is the answer. An APS (Attending Physicians Statement) is usually the cause for delays in the underwriting process. The insurance company requests a copy of your medical records from your doctor. Many physicians have a service that handles these requests for them, and others are required to allocate valuable time of their administrative staff to complete these

requests. If an agent or broker asks you to call your doctor to check on the APS, do so with great care. The APS is considered a nuisance, and aggravating the staff to get this done never helps. On the other hand, if you have a great relationship with your physician, a warning this request will be coming through may

be appreciated and help expedite its processing. In addition, if you have a blemish in your medical history that you disclosed on your application, an underwriter may discount it if your physician is willing to make an additional statement in regards to its benign nature.

So remember, underwriting is the time for the educated consumer and the quality advisor to team up and make sure that the insurance company is offering the absolute best price structure possible. First offers are not final offers. Illustrations are hypothetical costs. It's a buyers' market. The carriers want your business, make them earn it.

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How Much Life Insurance Do I Need?

Volumes have been written on this subject. They are all equally correct and incorrect at the same time. Ask a widow if her spouse had enough. Ask a terminally ill father if he wishes he had more coverage. Ask the thousands of people who pay year after year for insurance they never “use”. Then ask your insurance agent how much you need.

After all that, if you are lucky you will be able to answer the most important question, “Do I feel adequately covered?” In the end this question can be answered, but trying to calculate the need is virtually impossible.

How much you “need” depends on what you expect insurance to “do.” This relatively simple idea can lead to a complex calculation. Insurance death benefits may be needed to replace income, pay off debt, fund college educations, upgrade lifestyle, pay estate taxes, equalize estates to beneficiaries, or purchase a business

interest from a partner. You have to fully understand what you believe an insurance death benefit needs to do before trying to figure out how much you should buy.

Once you understand what you need death benefits to provide, you must then make some very key assumptions:

- What other resources are available?
- What rate of return can I expect my assets to generate?
- How do my needs change over time?

After understanding what you need the death benefit to do and deciding on these key assumptions, you can then calculate how much death benefit will cover those needs. This calculation should be a part of a well-thought-out financial plan.

Aaron Julian, CFP®

COMMERCE FINANCIAL ADVISORY SERVICES CHECKLIST

NEEDS ASSESSMENT:

- Financial, Personal and Family Situation
- Goals and Objectives
- Concerns/Attitudes

FAS PROFESSIONALS:

M. Ellen Simmons, JD, CPA
Steve Harmon, JD, MBA
Guy Hockerman, CPA, CFP

CREATE AND GROW WEALTH

- Financial Planning
- Portfolio Analysis
 - Asset Allocation
 - Diversification
 - Risk/Return
- Investments
 - Marketable
 - Non-Marketable
- Compensation and Retirement Benefits Management
- Private Banking
 - Personalized Banking
 - Customized Credit Services

PROTECT AND PRESERVE WEALTH

- Retirement Planning
- Tax Planning
- Insurance Analysis
 - Adequate?
 - Appropriate?
 - Cost Effective?
- Education Planning
- Protecting Your Assets
- Protection in Case of Incapacity
 - Long-Term Care
 - Successor Trustee
 - Health-Care Power of Attorney

DISTRIBUTE AND TRANSFER WEALTH

- Business Succession
 - Lifetime Transfer
 - Transfer at Death
 - Business Valuations
- Estate Planning
 - Titling Assets
 - Lifetime Gifts
 - Charitable Planning
 - Executor/Trustee Selection
 - Distributions to Beneficiaries
 - Tax Efficiency
 - Control Issues
 - Special Situations
 - Trusts and Asset Management

What issues concern you? Consult your Commerce Trust representative today to see how we might help.

What Are They Talking About?

Life Insurance Buzz Words/Phrases

Underwriting – The process by which an application becomes a policy. This often includes a review of the insured's medical history, driving history, financial statements, and other in-force insurance.

APS – Attending physician statement. This is basically a copy of your chart at your doctor's office.

Buying vs. Renting Insurance – Many insurance agents refer to term insurance as "renting" coverage while permanent policies are considered "buying" coverage.

Buy Term and Invest the Difference – An idea held by some, that insurance is not an investment, and you should always buy term insurance for the coverage you need and put all the extra premiums you would have given to the insurance company in other investments.

Rating –

Substandard, "Rated" – Approximately 5% of policies are issued below standard rates

Standard – Average rating

Preferred – Approximately 20% of applicants qualify at this level or higher

Preferred Best (Plus, Elite, Super, Ultra) – Many carriers have one or two ratings higher than preferred that reflect even more strict underwriting guidelines.

Target Premium – Considered to be the "Manufacturer's Suggested Retail Price" of a flexible premium policy. This is also very closely tied to the commissionable premium.

Commissionable Premium – The amount of premium on which the agent's commission is calculated. Commission payouts vary widely by insurance type and carrier, but normally fall within the 50-100% range of the first year premium. Premiums paid above this amount receive a much smaller payout, 2-5%.

Overfunding – Putting more than the target premium in a universal life policy in an effort to reduce premiums needed in later years to meet the owner's objectives. Referred to as front loading, or "feeding the engine."

"BLACK LISTED" BUZZ WORDS (SALES CONCEPTS TURNED LAWSUITS)

Vanishing Premium – Concept utilizing non-guaranteed dividends from one policy to fund a separate policy. Concept is now criticized as the "Vanishing Policy" concept.

Private Pension Insurance – Concept using life insurance cash values to generate an income stream in retirement. Overselling to prospects regardless of insurance need was its downfall.

Super ROTH – File under "future litigation." Many agents are comparing the taxation and funding capabilities of variable life insurance to a Roth IRA without compensation or contribution limits. Compliance departments everywhere are holding their breaths.

Locations

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TEL 314-746-8921

TOWN & COUNTRY

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Town and Country, MO
63017-0606
TEL 314-746-5070

ST. PETERS

435 Mid Rivers Mall Drive
St. Peters, MO 63376
TEL 636-949-8409

MISSOURI OFFICES

COLUMBIA

2000 Bernadette Drive
Columbia, MO 65203
TEL 573-886-5324

JOPLIN

211 S. Main Street
Joplin, MO 64801
TEL 417-626-4000

SPRINGFIELD

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Springfield, MO 65804-3603
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328 Felix
St. Joseph, MO 64501
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BLOOMINGTON

120 North Center Street
Bloomington, IL 61701
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