

## Introduction

Your time is valuable. When working with an insurance agent or financial planner, how can you keep the appointment brief but meaningful? Here are some hints:

### Ask About The Company

A company selling life insurance will be rated according to their ability to pay outstanding death benefit obligations. Standard & Poor's, Moody's, and A.M. Best are a few of the better-known companies that monitor the strengths and weaknesses of insurance companies conducting business in the United States.

How important is the financial strength of an insurance company? Well, how important is it for a patient to be treated in one of the best-rated hospitals in America? The answer to these questions will likely vary with each consumer or patient. If someone is shopping for the least expensive insurance product, they may be willing to overlook a poor financial strength rating in order to get the least expensive price. On the other hand, if a consumer wants a company who has an exceptional financial strength rating, they should be willing to pay a little more for the security of knowing the company they have chosen has a good chance of being there to pay future claims.



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### Get to Know the Agent

Besides deciding on an insurance company, another important decision is the choice of an agent, broker, or financial planner to work with. There are a number of issues to keep in mind when considering an insurance advisor:

#### **Experience**

Ask the prospective agent or broker about his/her background. How long have they been in the insurance or financial services industry?

#### **Education**

Agents and brokers are both encouraged and required to continue their insurance and financial planning education, not only to keep their various state insurance licenses, but also to maintain certain designations. Ask if the agent is studying for the designations of Chartered Life Underwriter (CLU) or Certified Financial Planner™ (CFP®).

#### **Titles**

Beware of misleading titles. There are many "agents" using fancy titles. Don't be afraid to ask about what the titles (or sometimes just initials) mean and how they were earned or awarded. Most meaningful designations are awarded following the completion of a series of courses and exams. There are, however, some that are used after the agent merely pays a fee and joins an organization.

Although a designation or advanced degree does not automatically indicate a particular agent or broker is the best choice for insurance advice, it does mean that he or she takes their commitment to learning about the industry seriously. Choosing a trusted insurance advisor should also be taken seriously. It can make all the difference in the world when it comes to preparing for the future and taking care of loved ones.

### Do Your Homework

Consumers in the United States are getting better about asking questions and doing research on their own. Access to the Internet certainly seems to be contributing to this phenomenon. So what do you need to know about the process of buying insurance?

A good start would be to generally know a little about the following topics:

- Risk Management
- The Planning Process
- Common Obstacles
- The Application Process

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### Risk Management

Risk can be defined in many ways. Risk related to the stock market has a very different meaning from that of the risk of operating a sailboat. For our purposes, risk is defined as the chance of financial loss due to an unforeseen hazard. Risk, unfortunately, comes as a natural and significant aspect of our financial environment. In general, there are four methods of dealing with risk:

#### **Risk Avoidance**

Some risks can be avoided. The risk of airplane accidents can pretty much be avoided by not flying. The risk of a sport-related injury can be avoided by not playing sports. For the majority of us, however, risk avoidance is not a practical solution for the many risks involved in our daily routines.

#### **Risk Assumption**

Concern for risk can be neglected due to its unrecognized existence, or it can be so inconsequential that we assume it naturally. When we leave the house in the morning, we assume a number of risks. Driving without a spare tire assumes a risk. The consequences of smoking are another risk that many have seen fit to assume.

#### **Risk Reduction**

If avoidance is impossible and assumption is unthinkable, it may be possible to take positive action to reduce (or minimize) the risk. Within this category we could include certain aspects of daily living, such as thoroughly cooking meat, scheduling periodic maintenance for our vehicles, and installing smoke detectors. The overall risk remains, but in a somewhat modified and possibly diminished capacity.

#### **Risk Transfer**

Some of the most important risks faced by individuals and businesses cannot be avoided or assumed, and reduction doesn't provide adequate peace of mind. A method must then be identified to shift the risk to others. One non-insurance method could be to form a corporation. Here the stockholders would limit their risk to their investment, while the creditors would assume much of the remaining risk. Another non-insurance method would be subcontracting. In this case, the general contractor shifts a portion of the risk to the subcontractors. Yet another might be to use mass transit rather than driving our own vehicle. This solution, however, exposes the rider to other risks, so most (outside major metropolitan areas) have collectively decided to ignore this option.

Insurance is, by design, an excellent device to transfer risk. When the frequency of the occurrence is low, but the potential severity of the financial loss is high, insurance can usually be conveniently priced and thus becomes a viable solution in managing risk.

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### The Planning Process

Planning, also referred to as "needs analysis," can generally take one of three similar forms; whichever form is best suited for solving your needs at the time, is the right form for you.

#### **Single-Purpose Form**

A simple evaluation of a single financial issue or service. This could be mutual fund savings for college or the purchase of automobile insurance.

#### **Multi-Purpose Form**

Here the emphasis is on the integration of many categories of potential risk and life insurance and estate planning—with its many aspects of property ownership, trust arrangements, and tax laws—as examples of this form.

#### **Comprehensive Form**

This form tries to encompass all the personal and financial situations of a family and it usually requires the expertise of a team of professional advisors. This is also the most time consuming of the three forms.

Regardless of the form, the process itself typically occurs in the following 6 steps or stages:

- **Establish Financial Goals:** This encourages the expression of concerns, hopes and goals, and assists in quantifying those goals and establishing timelines.
- **Gather Relevant Data:** Both objective and subjective information is gathered. This also encompasses the review of tax returns and other relevant documents.
- **Analysis of the Data:** Detailed analysis identifies the strengths and weaknesses of the current plan. A computer analysis is often useful for independent review of the strictly numeric aspects.
- **Development of a Plan:** This encompasses the development and recommendation of alternative strategies.
- **Review and Implementation of the Plan:** This involves a detailed review of the current plan, as well as implementation of recommended changes
- **Periodic Review of the Plan:** Once implemented, periodic monitoring of the performance of financial vehicles relative to then-current life cycle or lifestyle changes must be conducted.

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### Common Obstacles

Sounds easy, doesn't it? But there are numerous roadblocks that often impede the planning process. These include:

- Lack of direction
- Procrastination
- Debt
- Inflation
- Taxes
- Emergencies

### What if You Fail to Plan?

#### Federal statistics show that by the age of 65 ...

173 of 1,000 Americans had died prior to age 65.

192 had annual incomes under \$10,000.

537 had incomes between \$10,000 and \$50,000.

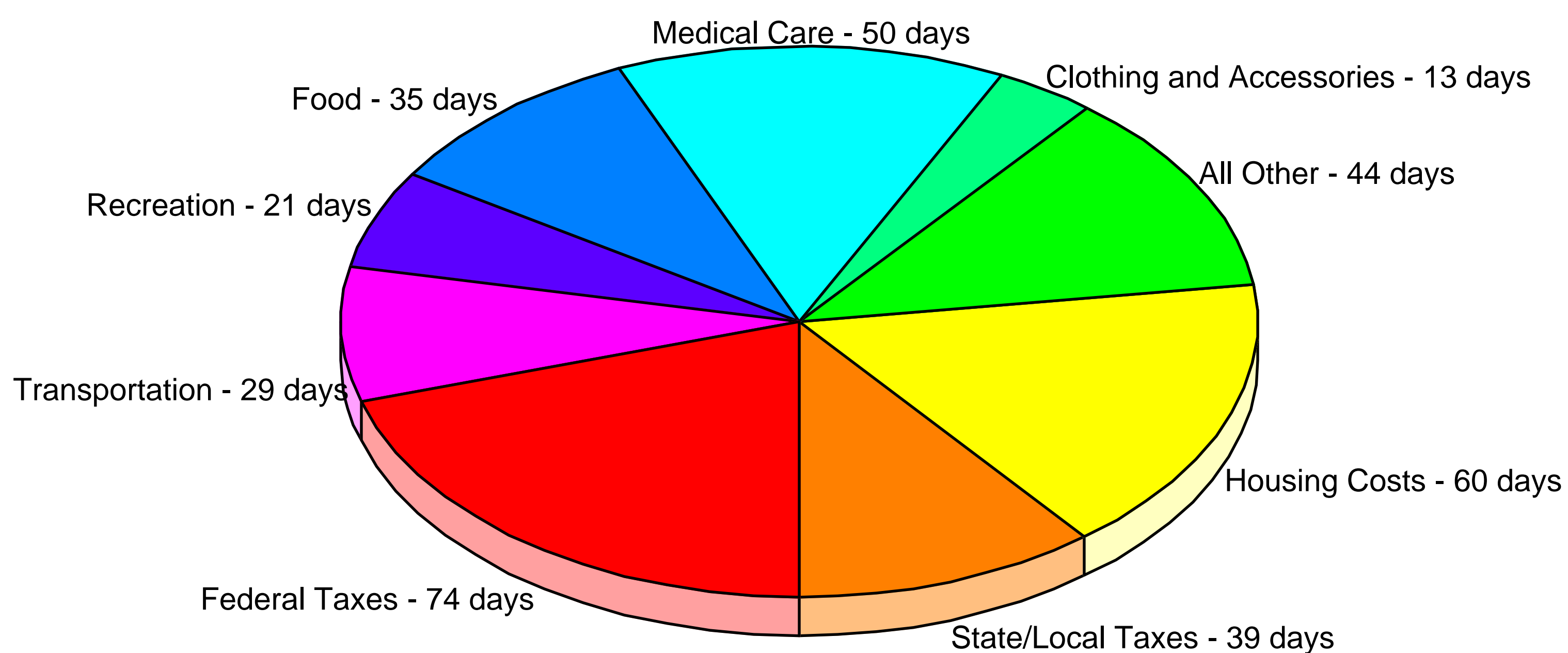
Only 98 out of 1,000 people had incomes over \$50,000.

**Being in that select 9.8% takes planning!**

Sources: U.S. Census Bureau, 2006; A Profile of Older Americans: 2007, Administration on Aging, Department of Health and Human Services

### Is Anything More Certain Than Death & Taxes?

According to the Tax Foundation, the average person had to work 113 days to pay all government taxes in 2008! The average year breaks down something like this:



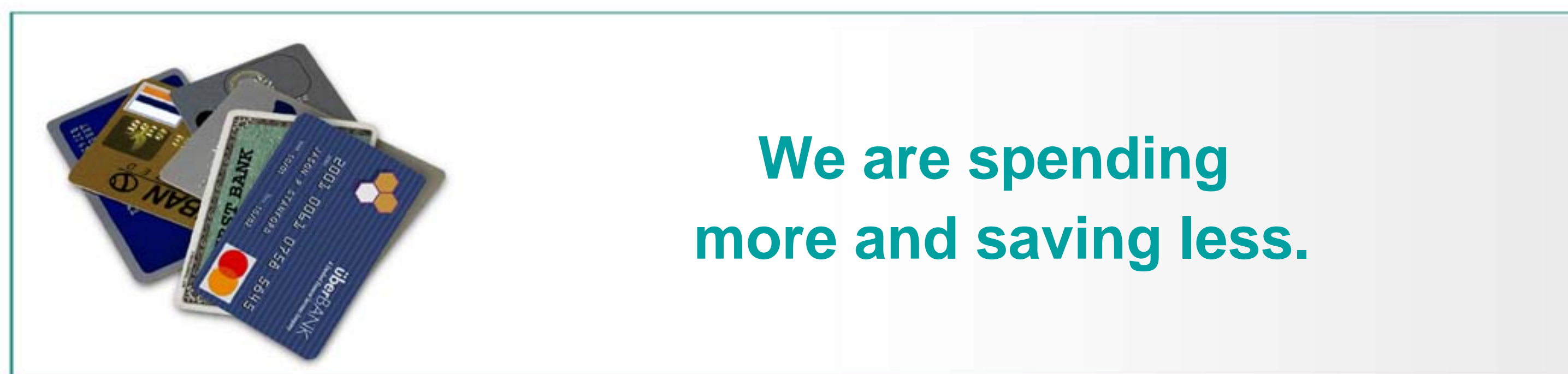
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### Can You Afford Debt?

On January 30, 2006, the Commerce Department reported that the personal savings rate fell into negative territory for the entire year. It was reported as - 0.5%, meaning that Americans not only spent all of their after-tax income but also had to dip into previous savings or increase borrowing. This has occurred only twice before—in 1932 and 1933—two years when the country was struggling to cope with the Great Depression.

The personal savings rate has declined from 10.8% in 1984 to 0.5% in 2007.

*Bureau of Economic Analysis, U.S. Department of Commerce, January 2008*



### Do You Know the Effects of Inflation?

From 1997 to 2007 the Consumer Price Index has averaged an annual increase of 2.69%. The differences in going to the grocery store between 1997 and 2007 might have been:

	Dec 1997	Dec 2007
Gallon of gas, regular unleaded	\$ 1.18	\$ 3.02
Loaf of Bread	.88	1.28
Ground Chuck, 1 lb.	1.81	2.70
Chicken, 1 lb. whole fryer	1.00	1.17
Eggs, one dozen Grade A large	1.17	2.10
Red Delicious Apples, 1 lb.	.90	1.12
Bananas, 1 lb.	.46	.53
Tomatoes, 1 lb.	1.62	2.15
Orange Juice, 12 oz, frozen concentrate	1.67	2.53
Coffee, 1 lb.	4.16	3.69
Iceberg lettuce, 1 lb.	.70	.95
<b>Total Bill</b>	<b>\$15.55</b>	<b>\$21.24</b>

*Source: U.S. Bureau of Labor Statistics, January 2008*

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### How Do You Keep Up?

#### With Taxes?

$$\begin{array}{c} \text{Earnings Rate} \\ \times \\ (100\% - \text{Tax Rate}) \end{array}$$

#### For Example:

A 5.5% rate of return multiplied by (100% less 25%) nets only 4.13%

#### With Inflation AND Taxes?

$$\begin{array}{c} (\text{Earnings Rate} - \text{Inflation Rate}) \\ \times \\ (100\% - \text{Tax Rate}) \end{array}$$

#### For Example:

And a 5.5% rate of return less a 3.0% inflation rate multiplied by (100% less 25%) nets only 1.875% ...

... and this just keeps you even with taxes and inflation. It'll take a lot more than 5.5% to actually grow your assets.

### The High Cost of Procrastination



This individual makes \$1,000 annual contributions starting at age 28 for only 7 years and then stops. All sums grow at 10% until age 65.

**Total contribution: \$7,000**  
**Value at Age 65: \$200,310**



This individual waits 7 years until age 35 to begin making \$1,000 annual contributions for 30 years. All sums grow at 10% until age 65.

**Total contribution: \$30,000**  
**Value at Age 65: \$199,037**

The late starter contributed \$23,000 more money yet ended up with \$1,273 less! That's more than a \$24,000 advantage for starting early!

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### The Application Process

If the decision is made to buy insurance, the next step is usually for your insurance agent to fill out an application. After the application has been completed, review it carefully before signing.

The application can be submitted with or without an initial premium. If any payment is submitted, a conditional receipt should be issued containing a temporary insurance agreement. This temporary agreement may bind the insurance company up to a set limit, pending the results of the underwriting process. Pay particular attention to the conditions of this agreement.

Following submission of an application, one of the next things the agent or broker will do is schedule a paramedic or medical exam for the insured. The medical exam will generally be conducted by a company-approved physician or nurse, not your family physician. You may request that copies be sent to your doctor, however.

Insurance companies will also routinely request information through MIB Group, Inc. (the Medical Information Bureau), a clearinghouse of medical information shared between insurers.

Once all the required information is gathered, the home office underwriter assigned to review the insured's application will issue a classification for the insured. Classifications normally range from "preferred" or "select" for the very healthy, to "standard" for those of average health. Additionally, there may be a sub-standard rating assigned to those insureds that have particular chronic or life shortening medical conditions. Don't be fooled by the actual name assigned to the underwriting classification. Although the actuaries may determine the rates, the marketing department may be involved with how it is eventually labeled. One company's preferred classification may be priced cheaper than another company's select rate.

### Conclusion

Needs analysis is a generic term used within the insurance industry to identify the process of quantifying a variety of financial needs, including life insurance. The techniques for calculating the need can vary considerably and there exists a variety of computer and worksheet models that can calculate financial objectives. The insurance professional assisting you has been trained to keep your best interests in mind during this process.