LESSON 3.2 STANDARD COMPONENTS OF A LIFE INSURANCE POLICY

So far you have learned about term life insurance, permanent life insurance, and payment options. Today we are going to dive into some of the standard components of a life insurance policy. By the end of today, you will use knowledge of the components of a life insurance policy — specifically policy provisions — to explain a policy to a client.

Life insurance contracts share several standard components, including the application, the policy, exclusions, riders, and provisions. **Provisions** are statements or clauses in an insurance contract that lay out the exact terms and conditions by which coverage is provided, the extent of coverage, along with any restrictions. Provisions can be added with attached forms, called riders. **Riders** are provisions that modify a policy in some way, either unconditionally or upon the existence of some condition. Riders can provide additional benefits or apply restrictions.

A provision can also describe what is not being covered. That is called an **exclusion**. A life insurance policy typically, unlike some other insurance policies, has no exclusions unless an endorsement for an exclusion is added at the time the policy is issued.

There are many foundational provisions common to life insurance policies. The first provision we are going to look at is called the **Entire Contract Provision**. As you have already learned, the first document in the contract process is an application, which is a statement of information by the prospective insured. A complete, correct, and signed application is attached to the policy and becomes part of the contract. A policy contains policy forms. The forms include definitions, an insuring agreement, and conditions. The contract terms can be amended or waived only by an endorsement, requested by the owner and issued by the insurer at the time the policy is put in place.

No agent has authority to waive or amend any provisions in the contract of insurance once it is issued. This means that neither the agent, the company, nor the client may change the contract after it is written and accepted. With a life insurance policy, the agent has no authority. After the policy is issued, the owner is the only person who can make changes. This may be accomplished by the act of the owner not paying the premium, which results in the policy lapse and a variety of potential consequences that may be addressed in a reinstatement period.

The second provision is the **Misstatement of Age or Sex provision**. A misstatement of age or sex is not considered a material misrepresentation in a life insurance contract. It will not void the contract, which means that misstatement is not serious enough for the company to recall the contract. If the misstatement is discovered before the death of the insured, however, there are three things that might occur. First, the policy will be amended. Second, the premiums may be increased, and third, the death benefits may be reduced. Why do you think the misstatement of age and/or sex might impact premiums and benefit?

If you said that a misstatement of age or gender might change the risk of covering the insured, you are correct. Remember there are statistical tables used by insurance companies that track the likelihood of death by both age and gender. The insurance company bases premium charged for a life insurance policy, in part, on these tables. If the misstatement is discovered after death, the insurer will adjust the death benefit (or refund the premium) to the amount it would have been had the correct information been given.

The third provision, also called the "**free-look period**," gives an insured time to examine a policy within a given period of time. If the insured is dissatisfied, the policy can be returned for a full refund of premium. State insurance codes require a right to examine. Most states require a minimum review period of 10 days beginning on the date the policy is delivered.

What if Sally is in the "free-look period" of a life insurance policy. She has a new job and can finally afford to buy a policy that will give her some future security. Unfortunately, she loses the job and does not have enough financial reserves to now afford the policy going forward. She is relieved to find out that she can back out of the policy agreement. Life situations change and insurance companies know this. It is in their best interests to work with a potential client or an existing client.

The fourth provision we are going to discuss is the **grace period**. A grace period for premium payment is a length of time past a premium's normal due date that the policy remains in force despite the premium being unpaid. State insurance codes require a grace period. The standard timeframe is 30 or 31 days. Do you think the grace period is important? Explain why you think it is or is not important. What would happen if no grace period was given? What do you think will happen if an insured dies during the grace period?

Hopefully, you think it is important for a grace period to be in place to protect the insured. There are times when an insured may either forget to pay a premium, is unable to pay because of a momentary financial problem, or is too ill to pay. Missing a payment just happens sometimes. If someone misses a payment and dies before they get a chance to pay it, should everything be lost? It would be if a grace period did not exist. The grace period is set in place to protect the insured should they miss a payment or die before they can pay it. If an insured dies during the grace period, the insurer pays the death benefit, minus the owed premium.

One of the reasons the insurance companies do such a good job in determining the insured's risk is because of something called the **incontestable clause**. This provision makes a policy incontestable after a certain period of time. That means that after two years, even if there is a problem with the accuracy of the information provided by the insured, the company will pay the benefit. Typically, an insurer has two years from the date a policy is issued to contest the accuracy of information about the insured. A death claim is rarely denied after two years. However, in some states, recent case law allows a company to challenge the claim after two years if there was willful and intentional fraud on the part of the insured that would have affected the company's original decision to insure.

There are three circumstances in which the incontestable clause is not applicable.

1. First, there is impersonation, which is a kind of fraud. For example, a man with a serious congenital heart condition knows he does not have long to live. He talks his identical twin brother into taking the requested life insurance medical exam for him. The life insurance with a guaranteed death benefit is put in place, and the beneficiary is the twin who stood in for his ill brother. The brother with the heart condition, now the insured, dies just six months later. When the insurance company happens to discover the cause of death, they realize there is fraud by impersonation. Therefore, they do not pay the death benefit and are entitled to pursue further legal action.
2. The second circumstance is a lack of insurable interest. We learned this early on. Do you remember? In order to be able to insure, there has to be insurable interest in the insured on the part of the policy owner.
3. The third circumstance is the intent to murder. Many books and movies have been created describing this scenario, both fictional and real. For example, a wife takes out an insurance policy on her new husband. She has an insurable interest; she is married to him. However, a year later, the husband begins to have symptoms of what seems to be a recurring illness. After a few months of suffering and being misdiagnosed, he dies. He is buried quickly. An insurance investigator notices that the wife has been married three times before, and all three of those husbands died under suspicious circumstances. The recent husband's body is exhumed, and with testing, it is discovered that he was given a common household poison over time. Will the wife receive the death benefit from the life insurance policy? No.

Impersonation, lack of insurable interest, and murder are all circumstances that will void a policy.

The sixth provision is the **Suicide Provision**. Virtually all life insurance policies include some type of suicide provision. Most states allow a company to deny a claim if death by suicide occurs within a certain timeframe. Typically, that timeframe is one or two years from the date a policy is issued. At the conclusion of the specified timeframe, the insurer pays the claim. If death by suicide occurs within the first year from the date a policy is issued, the insurer may refund any premium paid on the policy to the beneficiary.

The final provision we will be discussing today is the **reinstatement provision.** Insurance law in all 50 states requires the reinstatement provision, which stipulates the conditions under which a policy can be restored.

In most states, the reinstatement period is three years. In New York, it is five years. A reinstatement provision must meet state codes and insurance company guidelines. It requires an insured to re-qualify medically and to pay back all premiums. The provision often requires the insured to pay all past-due premiums, plus applicable interest. Remember that the only way an insured can get out of a life insurance policy if they want different terms or changes, is to let it lapse by not paying the premium. A reinstatement period may allow the client to renegotiate changes or additions to the policy. Of course, the premium may be higher for the adjusted policy.

You have covered the components of a life insurance contract, and you have looked at provisions that affect the policy when it is in place or when it lapses. Now, use the rest of the class period to get all the components and provisions set clearly in your mind.