CH. 7 PLANNING AHEAD

- ⑩ 7-1 Life Insurance: Who needs it?
- ⑩ 7-2 Spreading the Risk: How Insurance works
- ⑩ 7-3 Value for the Future

Ch 7-1 Life Insurance: Who needs It?

- ⑩What is life insurance?

- ⑩Who needs life insurance?

- ⑩How much life insurance does a family need to buy?

- ⑩What kinds of life insurances are available?

- ⑩What are the costs of these different insurances?

What is Life Insurance?

Life insurance is a contract to pay a specified amount of money to a designated person upon the death of the policy-owner.

🔟 Insurance is based on two ideas: risk sharing and statistical probability

🔟 Every person faces the possibility of financial disaster caused by an unpredictable event such as an accident, fire, flood, illness, or death of principal wage earner.

🔟 Insurance companies manage the pooled money (premiums) and in the event of a loss the beneficiaries receive money from the pooled money.

Who needs life insurance?

⑩If an income provider in a family dies, then that event puts a financial burden on the family. Having a life insurance policy large enough to replace all or most of the income that is needed for the dependents to survive financially after the death of a family provider. Life insurance is purchased to protect the dependent members of a family.

How much life insurance does a family need to buy?

⓿ An ideal goal is to have the insurance provide enough income for the family to continue its current standard of living. You should attempt to replace your family's usual *net income*, that is , the amount that remains after income and FICA taxes have been deducted.

⓿ 75% of the previous gross income would probably accomplish this. However the premiums may be to high.

⓿ At least 60% of gross income would probably avoid a serious lowering of your family's standard of living.

What kinds of Life Insurance is available?

- Term Insurance
- Cash-Value Insurance

Term Insurance

🔟 Group life – Purchased through an employer; lower rates

🔟 Renewable convertible term – One-, five-, or ten-year terms; renewable and convertible

🔟 Decreasing term – Like renewable convertible term but less expensive and with a gradually decreasing death benefit

Cash-Value Insurance

- Whole Life – Combines savings with insurance; can be cashed in for its accumulated cash value

- Limited Payment – Higher premiums for a fixed number of years, such as 20; builds up cash value more quickly than whole life

- Endowment – Emphasis on high cash value buildup; very high premiums

- Universal Life – Combines savings with insurance; can be cashed in for its accumulated cash value

What are the costs of these different insurances?

- ⑩ To find the best price for both term insurance and cash-value life insurance, you should shop around and compare the prices that different insurance companies offer.

- ⑩ The proceeds paid to a beneficiary from some kinds of life insurance policies are generally free from federal income taxes but may be subject to other taxes, such as an estate tax. Tax laws changes from time to time, so you should obtain up-to-date information from a tax adviser.

Try Your Skills

	Current Earnings	Age	Income Replacement	Amount of Insurance
1.	$65,000	35	75%	
2.	65,000	45	60%	
3.	40,000	55	75%	

Try Your Skills

	Current Earnings	Age	Income Replacement	Amount of Insurance
1.	$65,000	35	75%	7.5 * (65,000) = 487,500
2.	65,000	45	60%	
3.	40,000	55	75%	

Try Your Skills

	Current Earnings	Age	Income Replacement	Amount of Insurance
1.	$65,000	35	75%	7.5 * (65,000) = 487,500
2.	65,000	45	60%	6 * (65,000) = 390,000

Try Your Skills

	Current Earnings	Age	Income Replacement	Amount of Insurance
1.	$65,000	35	75%	7.5 * (65,000) = 487,500
2.	65,000	45	60%	6 * (65,000) = 390,000
				7 *

Try Your Skills (2)

	Amount of Insurance	Age	Type	Premium
4.	$100,000	25	Term	
5.	100,000	25	Whole life	
6.	200,000	35	Term	
7.	200,000	35	Whole life	
8.	300,000	45	Term	
9.	300,000	45	Whole life	

Try Your Skills (2)

	Amount of Insurance	Age	Type	Premium
4.	$100,000	25	Term	$207
5.	100,000	25	Whole life	
6.	200,000	35	Term	
7.	200,000	35	Whole life	
8.	300,000	45	Term	
9.	300,000	45	Whole life	

Try Your Skills (2)

	Amount of Insurance	Age	Type	Premium
4.	$100,000	25	Term	$207
5.	100,000	25	Whole life	918
6.	200,000	35	Term	
7.	200,000	35	Whole life	
8.	300,000	45	Term	
9.	300,000	45	Whole life	

Try Your Skills (2)

	Amount of Insurance	Age	Type	Premium
4.	$100,000	25	Term	$207
5.	100,000	25	Whole life	918
6.	200,000	35	Term	2(254) = 508
7.	200,000	35	Whole life	
8.	300,000	45	Term	
9.	300,000	45	Whole life	

Try Your Skills (2)

	Amount of Insurance	Age	Type	Premium
4.	$100,000	25	Term	$207
5.	100,000	25	Whole life	918
6.	200,000	35	Term	2(254) = 508
7.	200,000	35	Whole life	2(1374) = 2748
8.	300,000	45	Term	
9.	300,000	45	Whole life	

Try Your Skills (2)

	Amount of Insurance	Age	Type	Premium
4.	$100,000	25	Term	$207
5.	100,000	25	Whole life	918
6.	200,000	35	Term	2(254) = 508
7.	200,000	35	Whole life	2(1374) = 2748
8.	300,000	45	Term	3(562) = 1686
9.	300,000	45	Whole life	

Try Your Skills (2)

	Amount of Insurance	Age	Type	Premium
4.	$100,000	25	Term	$207
5.	100,000	25	Whole life	918
6.	200,000	35	Term	2(254) = 508
7.	200,000	35	Whole life	2(1374) = 2748
8.	300,000	45	Term	3(562) = 1686
9.	300,000	45	Whole life	3(2127) = 6381

Assignment

🔟P. 328 1-22
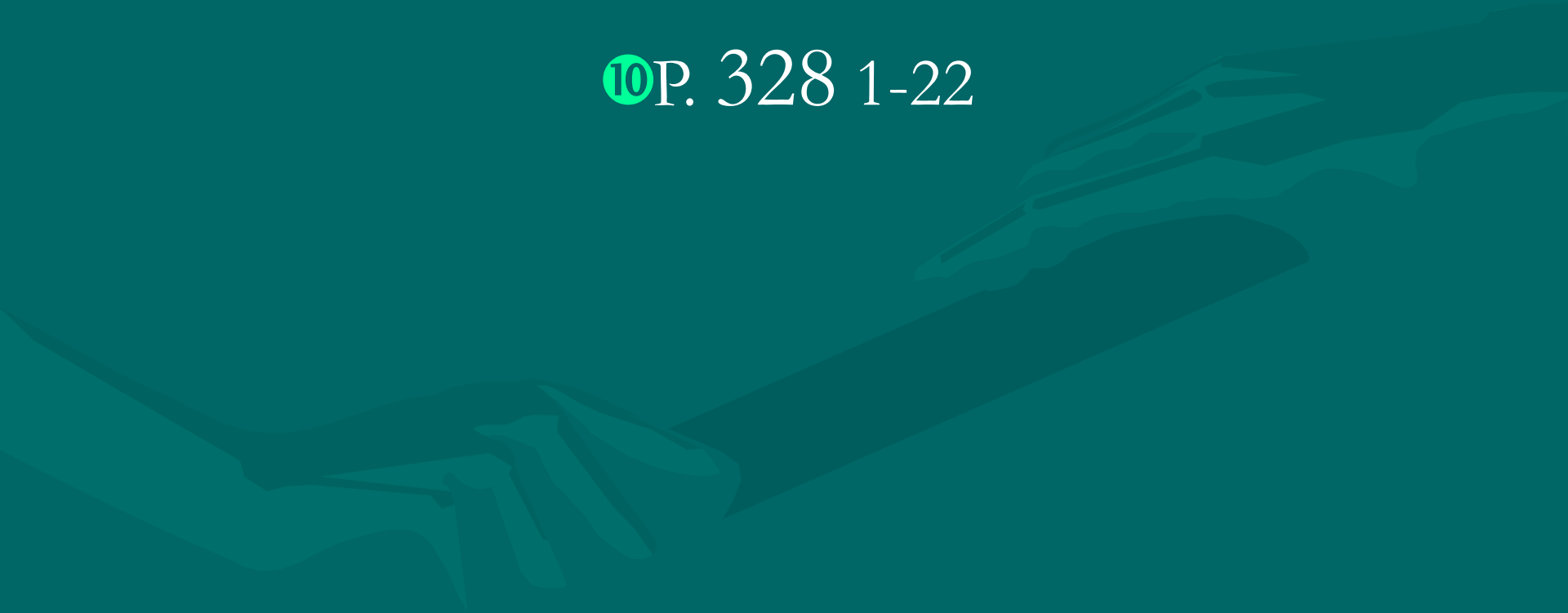
Chapter 7-2

⑩SPREADING THE RISK: HOW INSURANCE WORKS

OBJECTIVES

⓾Understand how life-expectation tables are used to estimate the probability that an individual will die within one year.

⓾Learn how an insurance company determines its premium schedule to make a reasonable profit.

Probability of an Event

$$P(E) = m/n$$

Where $P(E)$ = the probability of an event E

m = the number of times the event occurs

n = the number of all possible outcomes

Example

Using the chart on page 331 of your textbook, find the probability of a 16-year old person will be alive 1 year from today.

# of 16-year old people alive 1 year later

Total number of 16- year old people

$$\frac{99{,}921}{100{,}000} = .99921$$

P(E‘) = <u>Probability of a 16-year old will die in 1 year</u>

Total number of 16-year old people

$$P(E') = \frac{79}{100,000} = .00079$$

The sum of the probabilities of an event and its complement is 1

P(E) + P(E‘) = 1