Group Life Insurance, Retirement Plans, And Social Security Disability Program

This chapter helps broaden your life insurance knowledge. It teaches you about a variety of topics, from group life insurance and plans specific for businesses, to retirement plans and social security benefits.

TERMS TO KNOW

Blanket insurance — a single policy that provides multiple types of coverage
Contest — to dispute or bring action against
Earned income — salary, wages, or commissions, but not income from investments, unemployed benefits, or similar sources of income
IRS (Internal Revenue Service) — a U.S. government agency responsible for collecting taxes and enforcement of the Internal Revenue Code
Policy endowment — maturity date
Vesting — the right of a participant in a retirement plan to retain part or all of the benefits

A. Third-Party Ownership

Most insurance policies are written where the insured and owner of the policy is the same person. However, there are situations in which the contract may be owned by someone other than the insured. These types of contracts are known as **third-party ownership.** *Third-party owner* is a legal term used to identify an individual or entity that is not an insured under the contract, but that has a legally enforceable right under it. Most policies involving third-party ownership are written in business situations or for minors in which the parent owns the policy.

B. Group Life Insurance

Educational Objective:

II.G.1. Be able to differentiate between the basic characteristics of group and individual policies concerning:

a. An individual insurance policy vs. group master contract vs. individual certificate of insurance
b. Medical examinations and eligibility
c. Contributory and noncontributory plans
d. Employer responsibilities:

   i. Selection of coverage
   ii. Nondiscrimination within a class of employees

iii. Record keeping
iv. Enrollment

In contrast to individual life insurance, which is written on a single life, and in which the rate and coverage is based upon the underwriting of that individual, **group life insurance** is issued to the sponsoring organization, and covers the lives of **more than one individual** member of that group. Group insurance is usually written for employee-employer groups, but other types of groups are also eligible for coverage. It is usually written as **annually renewable term** insurance. Two features that distinguish group insurance from individual insurance are

- Evidence of insurability is usually not required (unless an applicant is enrolling for coverage outside the normal enrollment period); and
- Participants (insureds) under the plan do not receive a policy because they do not own or control the policy.

Instead, each insured participant under the group plan is issued a **certificate of insurance** evidencing that they have coverage. The actual policy, or **master policy/contract**, is issued to the sponsor of the group, which is often an employer. The group sponsor is the policyholder and is the one that exercises control over the policy.

Know This! Group insurance is written as annually renewable term insurance.

Know This! In group insurance, the master contract is for the employer, and certificates of insurance are for individual insureds.

Group underwriting differs from that of individual insurance, and is based on the group characteristics and makeup. Some of the characteristics of concern to a group underwriter include the following:

- **Purpose or nature of the group** — The group must be created for a purpose other than to obtain group insurance.
- **Size of the group** — The larger the number of people in the group, the more accurate the projections of future loss experience will be. This is based on the Law of Large Numbers of similar risks.
- **Turnover of the group** — From the underwriting perspective, a group should have a steady turnover: younger, lower-risk employees enter the group, and older, higher-risk employees leave.
- **Financial strength of the group** — Because group insurance is costly to administer, the underwriter should consider whether or not the group has the financial resources to pay the policy premiums, and whether or not it will be able to renew the coverage.

Another unique aspect of group underwriting is that the cost of the coverage is based on the average age of the group and the ratio of men to women. In addition, in order to reduce adverse selection, the insurer will require a minimum number of participants in the group, depending on whether the employer or employees pay the premium.

1. Policies and Certificates of Insurance

Insurance companies only issue one policy for group life insurance plans – a **master policy**, which is issued to the sponsor of the group (often an employer).

Each individual plan participant receives a document called a **Certificate of Insurance**, which outlines the contract provisions and benefits.

The certificate of insurance must list the following information:

- The policy number;
- The name, address, and other contact information for the insurer;
- The name of the insured (the employer or sponsor of the group);
- The amount of insurance provided, and to whom the benefit is payable; and
- Any principal exclusions that appear in the contract.

An individual certificate is deemed to be "*individualized*" if it contains either the name of the employee covered or some other means of identifying to the employee covered that it is his or her individual certificate.

2. Enrollment

Application or **enrollment** process for group insurance means any steps required of a named insured in applying for a certificate under a group life policy, such as completing an enrollment form or submitting to medical examination if required by the insurer.

3. Medical Examinations and Eligibility

Group life insurance plans may be sponsored by employers, debtor groups, labor unions, credit unions, associations, and other organizations formed for a reason other than purchasing insurance. Insurance companies may establish a required minimum number of persons to be insured under a group plan.

In this state, a group policy must cover at least **10** eligible group members.

Group life insurance is underwritten on a group basis as opposed to an individual basis. Each participant completes a short application that clearly identifies the insured and the insured's beneficiary. Generally, if the group is large enough, there are **no medical questions** since the plan will be issued based upon the nature of the group and the group's past claims experience.

4. Contributory vs. Noncontributory

The employer or other group sponsor may pay all of the premiums or share premiums with the employees. When an employer pays all of the premiums, the plan is referred to as a **noncontributory plan**. Under a noncontributory plan, an insurer will require that 100% of the eligible employees be included in the plan. When the premiums for group insurance are shared between the employer and employees, the plan is referred to as a **contributory plan**. Under a contributory plan, an insurer will require that 75% of eligible employees be included in the plan.

5. Selection of Coverage

In some employee benefit plans, the employer contributes a fixed amount to the plan for each employee. The employee may then choose from a group of benefits for the one that best suits his or her needs. The benefits may include a retirement annuity, health insurance, life insurance, etc. There may also be a choice of providers from which to select coverage.

6. Nondiscrimination

To reduce adverse selection within a group, all employees must be eligible for coverage under a single-employer group policy. An employer may subdivide employees into classes (e.g., salaried employees vs. hourly employees); however, within any one group, **discrimination in benefits is prohibited**. All members of the group are entitled to the same set of benefits. Coverage may only be excluded if elected by an employee in writing.

7. Recordkeeping

Insurers issuing group life policies in this state are required to keep records of all transactions (original or copies) for a minimum period of 5 years following the delivery of a policy or contract. The records must include the following:

- The original policy application;
- Records showing the premiums received by the insurer;
- Records showing the amount of commissions paid and to whom;
- Any correspondence, written solicitations or proposals sent by the insurer to a prospect, applicant, or insured, or received by the insurer;
- A copy of outline of coverage or disclosure statement; and
- Any other pertinent records.

8. Characteristics of Group Life Insurance

Educational Objective:

II.G.2. Know the following characteristics of group life insurance:

a. Eligible groups (CIC 10202.5, 10270.505, 10270.55, 10270.57)
b. Coverage for dependents of insureds (CIC 10203.4)
c. Types of life policies and premiums (CIC 10200)
d. Incontestability (CIC 10206)
e. Exclusions of war, military, and aviation risk (CIC 10206.5)
f. Misstatement of age (CIC 10208)
g. Conversion privilege (CIC 10209)
h. Grace period coverage (CIC 10209)
i. Blanket life insurance (CIC 10220, 10222)
j. Domestic partnership (CIC 10121.7)

Eligible Groups and Insureds

Group life insurance plans may be sponsored by employers, debtor groups, labor unions, credit unions, associations, and other organizations formed for a reason other than purchasing insurance. Insurance companies may establish a required minimum number of persons to be insured under a group plan.

Single Employers

When a policy is issued to an employer, the employer or trustee will be the policyholder to insure employees of the employer for the benefit of persons other than the employer. A policy on which no part of the premium is paid by insured employees must insure all eligible employees, except those who reject such coverage in writing.

Labor Unions

A policy issued to a labor union, or similar organization to insure members of the organization for the benefit of persons other than the union or organization are subject to the following requirements:

- The members eligible for insurance under the policy must be all the members of the union or organization, or all of any class or classes thereof.
- The premiums for the policy must be paid either from funds of the union, or from funds contributed by the insured members specifically for their insurance, or from both. A policy on which no part of the premiums is to be derived from funds contributed by the insured members specifically for their insurance must insure all eligible members, except those who reject such coverage in writing.
- An insurer may exclude or limit the coverage on any person as to whom evidence of individual insurability is not satisfactory to the insurer.

Associations

An **association group** (alumni or professional) can buy group insurance for its members. The group must have at least 100 members, be organized for a reason other than buying insurance, have been active for at least two years, have a constitution, by-laws, and must hold at least annual meetings. These groups include, but are not limited to, trade associations, professional associations, college alumni associations, veteran associations, customers of large retail chains, and saving account depositors, to name a few. Association group plans may be either contributory or noncontributory.

Credit Unions

A group life policy may be issued to a credit union or to a trustee, or trustees or agent designated by two or more credit unions to insure the lives of members of the credit unions for the benefit of persons other than the policyholder, subject to the following requirements:

- All of the members of the credit union must be eligible for coverage;
- The premium for the policy will be paid by the policyholder from the credit union's funds and must insure all eligible members; and
- An insurer may exclude or limit coverage on any member as to whom evidence of individual insurability is not satisfactory to the insurer.

Debtor Groups

A policy issued to a creditor or its parent holding company or to a trustee, trustees or agent designated by two or more creditors, which are deemed to be the policyholder, is subject to the following requirements:

- The debtors eligible for insurance under the policy must all be the debtors of the creditor;

- The premium for the policy must be paid either from the creditors funds, or from charges collected from the insured debtors, or from both;
- An insurer may exclude any debtors as to whom evidence of individual insurability is not satisfactory to the insurer; and
- The amount of insurance on the life of any debtor may at no time exceed the greater of the scheduled or actual amount of unpaid indebtedness to the creditor.

Dependents of Insured Employees

Under group insurance policies, insurance may be extended to insure dependents of the insured, in amounts in accordance with a plan that precludes individual selection. The amounts cannot exceed 100% of the insurance on the life of the insured employee. The premiums for the insurance on the dependents may be paid by the employer, the employee, or the employer and the employee jointly.

The term **dependents** includes the insured's spouse and all children from birth until **26 years of age,** or children older than 26 years of age who are both incapable of self-sustaining employment by reason of an intellectual disability or physical handicap, and are mainly dependent upon the insured employee for support and maintenance. A disabled child must first be insured within 31 days of having reached the limiting age. Proof of the incapacity and dependency may be required once a year after the first 2 years of the child's attainment of the limiting age. The premiums for the insurance on the dependents may be paid by the employer, the employee, or the employer and the employee jointly.

Domestic Partnership

An insurer in California is required to provide the registered domestic partner of an employee, insured or policyholder the same coverage that would be provided to a spouse. The insurer must inform employers and guaranteed associations of this coverage.

A policy of group health insurance may require the status of the domestic partnership be verified by providing to the insurer a copy of a valid Declaration of Domestic Partnership. The policy may also require that the employee notify the insurer upon the termination of the domestic partnership. However, this information is required only if the insurer also requests verification of marital status and notification of dissolution of a marriage from an employee whose spouse is provided coverage.

Types of Policies

According to the California Insurance Code, any life insurer may issue life, disability, term, and endowment insurance on a group plan with premium rates that are lower than the usual rates for such insurance. Insurance under a franchise agreement or upon a wholesale basis may be written under rates more or less than the usual rates for such insurance.

Blanket Life Insurance

A **blanket** life policy would cover a group of people that are exposed to the same hazard. It differs from traditional group insurance in that it doesn’t name individual insureds and doesn’t issue certificates of insurance. The coverage under a blanket policy is temporary and only for the time the group is exposed to the hazards specified in the policy. Typical examples of blanket insurance would include airlines covering passengers while in flight, or schools covering students and teachers during the school hours.

The California Insurance Code permits insurers to offer blanket insurance to the following entities:

- Newspapers, magazines, or other similar publications for the purpose of insuring the following persons:
  - Those who deliver publications or collect payments for the publication;
  - Those who supervise the deliveries or collections;
  - Those who are wholesalers; or
  - Others in the distribution, sales, or marketing process of the publication;
- Religious, charitable, recreational, educational, athletic, or civic organizations;
- Employers who pay the benefits afforded by a voluntary plan of unemployment compensation disability insurance;
- Employers who provide benefits to any group of workers, dependents, or guests, limited to specified hazards incident to activities or operations of the policyholder; and
- An entertainment production company that provides benefits to any group of participants, volunteers, audience members, or contestants.

Blanket life insurance may be issued for a **term not exceeding one year** with premium rates less than the usual rates for such insurance. Blanket policies may be renewed.

When the insured pays the policy premiums, the insured may request from the insurer a copy of the policy in the form of a certificate.

A person may elect not to be covered by a blanket insurance plan by submitting a written request to the insurer. If more than 10% of the persons eligible for coverage elect not to participate, the insurance contract cannot be put into effect, or if it has been in effect, it cannot be renewed.

Conversion Privilege

Another characteristic of group insurance is the conversion privilege. If an employee terminates membership in the insured group, the employee has the right to convert to an individual policy ***without proving insurability*** at a standard rate, based on the individual's attained age. The group life policy can convert to any form of insurance issued by the insurer (usually whole life), *except* for term insurance. The face amount or death benefit will be equal to the group term face amount, but the premium will be higher. The employee usually has a period of **31 days after terminating** from the group in order to exercise the conversion option. During this time, the employee is still covered under the original group policy.

Other rules that apply to conversion involve the death or disability of the insured, and termination of the master policy. If the insured dies during the conversion period, a death benefit equal to the maximum amount of individual insurance which would have been issued must be paid by the group policy, whether or not the application for an individual policy was completed. If the master contract is terminated, every individual who has been on the plan for at least 5 years will be allowed to convert to individual permanent insurance of the same coverage.

Know This! When converting from group life to individual life insurance, evidence of insurability is not required.

Also, if the employee is not given notice by the employer or the insurer of his or her right to convert within 15 days of termination of employment, the Insurance Code requires that he or she be given an additional 25 days following the notice to apply for a conversion policy.

In no event, however, will an employee have more than 60 days following the end of any conversion period to elect to convert and pay the first premium for individual coverage, and there is no coverage after the initial 31-day conversion period until a new premium is paid.

A spouse or child who was covered by the group policy as a dependent has the same privilege to convert to an individual plan of insurance, also without evidence of insurability. All of the provisions previously described apply to a dependent's conversion.

Incontestability

The **incontestability clause** states that the insurer cannot contest the statements on the application after a policy has been in effect for a given length of time (2 years in the state of California). In other words, the insurance company may not rescind the contract on the basis of any error or misrepresentation on the part of the policyowner or insured after the policy has been in force for 2 years.

Misstatement of Age

The policy must contain a provision for the equitable adjustment of the premium or the amount of insurance payable in the event of a misstatement of the age of an employee.

War, Military, or Aviation Risk

Insurers may reduce or exclude liability for losses arising from war, military or naval service, and aviation.

C. Qualified Retirement Plans

Educational Objective:

II.G.3. Be aware that life insurance can be held within a qualified plan under very limited circumstances.

An employer-sponsored **qualified retirement plan** is approved by the IRS, which then gives both the employer and employee benefits such as deductible contributions and tax-deferred growth.

Qualified plans have the following characteristics:

- Designed for the exclusive benefit of the employees and their beneficiaries;

- Are formally written and communicated to the employees;
- Use a benefit or contribution formula that does not discriminate in favor of the *prohibited group* — officers, stockholders, or highly paid employees;
- Are not geared exclusively to the prohibited group;
- Are permanent;
- Are approved by the IRS; and
- Have a vesting requirement.

Know This! Qualified plans have tax advantages.

Life insurance can be held within a qualified plan under very limited circumstances: usually in some profit-sharing plans, defined contribution and defined benefit plans.

In addition to individual plans, different types of qualified plans are available and have been designed for use by small and large employers.

D. Social Security Disability Program

Educational Objective:

II.H.1. Be able to identify the Social Security system's requirements to be currently insured vs. fully insured for disability and survivors' benefits.

a. Know that the minimum requirement for workers under age 24 to obtain *currently insured* status is 6 credits in the last 3 years.
b. Know that beginning at age 24, additional credits are required to obtain *currently insured* status based on the worker's age at the time of disability.
c. Know that 40 credits is the requirement for *fully insured* status in order to obtain retirement and premium-free Medicare Part A benefits, and eligibility for Medicare Part B.

Social Security, also referred to as **Old Age Survivors Disability Insurance** — OASDI, is a federal program enacted in 1935, which is designed to provide protection for eligible workers and their dependents against financial loss due to old age, disability, or death. With a few exceptions, almost all individuals are covered by Social Security. In some respects, Social Security plays a role of federal life and health insurance, which is important to consider when determining an individual's needs for life insurance.

Social Security uses the Quarter of Coverage (QC) system to determine whether an individual is qualified for Social Security benefits. The type and amount of benefits are determined by the amount of **credits** or **QCs** a worker has earned. Anyone working in jobs covered by Social Security or operating their own business may earn up to a maximum of 4 credits for each year of work.

The term **fully insured** refers to someone who has earned **40 quarters** of coverage (the equivalent of 10 years of work), and is therefore entitled to receive Social Security retirement, premium-free Medicare Part A, and survivor benefits. If an individual is entitled to premium-free Medicare Part A, they are automatically eligible for Medicare Part B, but must pay a monthly premium.

An individual can attain a **currently insured** status (or partially insured), and by that qualify for certain benefits if he or she has earned **6 credits** (or quarters of coverage) during the 13-quarter period *ending with the quarter in which the insured:*

- Dies;
- Becomes entitled to disability insurance benefits; or
- Becomes entitled to old-age insurance benefits.

For younger workers, the number of quarters required to qualify for the benefits differs by age according to a table established by Social Security.

To qualify for **disability benefits** under Social Security, the disabled person must have earned a certain amount of credits. A maximum of 4 work credits can be earned each year. Generally, an individual needs **40 credits**, 20 of which have been earned in the last 10 years before the disability. In other circumstances, the amount of required credits varies by age:

- Before age 24: persons can qualify for benefits with only 6 credits earned in the 3 years prior to the start of the disability.
- Ages 24 - 31: persons can qualify for benefits if they have credit for having worked half of the time between age 21 and the start of the disability. *For example*, if Joe becomes disabled at age 27, he would need 12 credits (or 3 years' worth) out of the prior 6 years (between ages 21 and 27).
- After age 31: the number of work credits required varies even more, but at least 20 of those credits must have been earned in the 10 years immediately prior to becoming disabled. The following table applies to those born after 1929.

Age **Credits Needed**

31-4220

4422

4624

4826

5028

5230

5432

5634

5836

6038

62+40

Educational Objective:

II.H.2. Be able to identify the types of benefits paid and the insured status required for the following types of benefits:

a. Survivor: income benefits (spouse and minor children, and the effect of the "Blackout Period") and lump-sum death benefit
b. Disability income
c. Retirement income

CONDITIONS FOR PAYMENT	PAID TO	TYPE OF PAYMENT
RETIREMENT BENEFIT:		
Fully insured status and age 66* (or reduced benefits at age 62)	Retired individual and eligible dependents	Monthly benefit equal to the primary insurance amount (PIA)
DISABILITY BENEFIT:		
Fully insured status and total and permanent disability prior to the retirement age	Disabled worker and spouse and eligible dependents	Monthly disability benefit after a 5-month waiting period
SURVIVOR BENEFIT:		
Worker's death	Surviving spouse and dependent children	Lump-sum burial benefit if fully or currently insured Monthly income payments if fully insured

**The current full retirement age is 66, and is gradually increasing to age 67.*

Survivor benefits are death benefits paid to the worker's surviving spouse and dependent children under specified circumstances. A lump-sum burial benefit is available for a spouse living with the worker at the time of death, or a spouse or child who is eligible for Social Security in the month of the worker's death. Monthly income payments may also be paid to the following in the event of a fully insured (covered) worker's death:

- Surviving spouse, limited benefits available at age 60, full benefits payable upon reaching full retirement age (varies depending on year of birth).
- Surviving or divorced spouse, if caring for minor children under age 16 or disabled children, sometimes called a parent’s benefit. Once the minor reaches age 16, the parent is not eligible for Social Security retirement benefits again until retirement or age 60 ("Blackout Period").
- Dependent parents, age 62 or older.
- Unmarried children under age 18, or up to age 19, if full-time elementary or secondary (high school) students.

Social Security is funded by the taxes imposed on a worker's earned income. This is a payroll tax paid for by all employees and employers, including self-employed individuals. This tax is imposed on a certain percentage of the employee's income, referred to as the taxable wage base. The employer deducts the taxes from the employee's paycheck and contributes an equal amount. Part of the tax is applied to OASDI under **FICA** (the Federal Insurance Contributions Act), and part of the tax funds Medicare. Self-employed employees pay an amount that is equivalent to both the employee and employer's contribution.

E. Chapter Recap

This chapter touched on group life insurance, retirement plans, and Social Security benefits. Let's recap some of the important concepts:

GROUP LIFE INSURANCE

General Concepts

- Employer is the policyowner (receives a master contract); employees are the insured (receive certificates of insurance)
- No evidence of insurability
- *Conversion* -no evidence of insurability, within a specified number of days (usually 30 or31 days of termination)
- *Noncontributory* - employer pays 100% of the premium; requires 100% employee participation
- *Contributory* - employer and employees share the cost of premium; requires 75% participation

Eligible Groups

- Single employers
- Labor unions
- Associations
- Credit unions
- Debtor groups

Insured's Dependents

- Coverage cannot exceed 100% of insurance on the insured employee
- Dependents include:
  - Spouse;
  - Domestic partner;
  - Children up to age 26 (and beyond the limiting age with proof of dependency

Blanket Life

- Covers groups exposed to the same hazards (e.g., schools, airlines, entertainment venues)
- Issued for a term of no more than 1 year

QUALIFIED PLANS

General Characteristics

- Approved by the IRS
- Do not discriminate in favor of prohibited groups
- Have tax advantages
- Vesting requirements
- Permanent

SOCIAL SECURITY BENEFITS

Types of Benefits

- Retirement
- Disability
- Survivor

Insured Status

- *Fully insured* (40 quarters of coverage) - qualify for Social Security retirement, Medicare, and survivor benefits
- *Currently insured* (6 quarters of coverage) - qualify for some benefits