Choosing the Right Life Insurance Policy

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Life insurance can be confusing and confounding to many people. The concept is easy enough to understand - providing a death benefit for one's heirs in the event of an unexpected death - but the ways to provide that death benefit can be complicated and, sometimes, mysterious. In fact according to a recent study by the Life Insurance Marketing and Research Association (LIMRA), more than 80 percent of people who say they need more life insurance list difficulty in deciding the type to buy as a reason they have not yet purchased it.

Several factors may play into the ideal type of coverage for a particular person's needs, and that is the reason so many policy types exist. Factors such as your age, your ability to afford the premiums, your risk tolerance, the length of time the death benefit will be needed and your desire to recoup your premiums or even enjoy an opportunity for a gain in cash accumulation, all go into a decision that may be best made with the help of a trusted insurance professional. I have attempted to summarize the various kinds of life insurance on the market today and help position the purposes of each.

Annual Renewable Term

A term insurance policy with low initial cost. Premiums increase, usually on each policy anniversary. ART may be the ideal solution for short-term needs, such as a one- to five-year debt obligation. Summary: Lowest initial cost death benefit protection available Ten- to Thirty-Year Term: Term insurance policies in which premiums are guaranteed to remain level for all or part of the life of the policy. They generally renew at rates that increase annually after the initial term of the policy expires. They are ideal for fixed needs of mid-range duration. Longer needs may be more cost-effectively addressed with cash value insurance, though the size of the premiums may ultimately affect your decision. For example, if low cost is your primary goal a twenty- or thirty-year term policy may offer low premiums, but after the initial guaranteed premium period ends, the premium is likely to go up substantially. Summary: Fixed cost death benefit for a fixed period of time.

Universal Life (in general)

Universal life insurance is a cash value policy, which offers flexible premiums, within minimum and maximum guidelines. The death benefit can also be adjusted, within limits. The portion of the premium in excess of that required to pay the policy costs, is accumulated tax-deferred at interest rates that are reset regularly. A minimum interest-crediting rate is guaranteed in the policy. The cash value then pays the mortality and rider costs (if any) and may be accessed through partial surrenders and/or loans to use for emergencies, college funding, opportunities or to supplement retirement income.

Summary: Cash-value life insurance with premium and death-benefit flexibility.

Universal Life (with secondary guarantees)

Secondary guarantees offer the insured the ability to guarantee the death benefit, up to lifetime, by paying a premium that matches the Lapse Protection requirement for that age. It should be noted that varying the premium or the death benefit, or surrendering or borrowing from a policy with a secondary guarantee, will likely void the guarantee.

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Summary: Guaranteed death benefit protection at a fixed price for a mid- to long-range time period up to lifetime.

Universal Life (without secondary guarantees)

This type of insurance policy offers no death benefit protection unless cash value is maintained within the policy. Usually lower costs within this type policy offer more opportunity for cash accumulation than in a universal life policy with secondary guarantees. It can be used for low-cost protection or cash-value growth with moderate risk. Summary: Low cost, mid- to long-term death benefit protection with opportunity for cash accumulation.

Variable Universal Life

Another form of universal life insurance, in which the portion of the premium in excess of that required to pay the policy costs, is allocated to separate accounts much like mutual funds.

The mortality and rider costs (if any) are deducted from the separate accounts monthly. Money can be accessed from the separate accounts through partial surrenders and/or loans to use for emergencies, college funding, opportunities or to supplement retirement income. Secondary guarantees may be available for a stipulated premium, which offers the insured a guarantee the death benefit will not expire even if the separate accounts run out of money. These guarantees may be for a number of years or to a certain age, often up to age 100.

Summary: Mid- to long-term death benefit protection with opportunity for cash accumulation and/or tax advantaged retirement income commensurate with increased risk.

Whole Life

Another form of permanent life insurance, whole life provides a fixed level premium and a fixed level death benefit for life (in most cases to age 100). The policy's guaranteed cash value typically grows at a rate that will enable it to equal (endow) the specified death benefit at age 100. Some insurance companies offer "participating" policies in which a portion of the premium may be returned to the client as a dividend. The dividends, if paid, may be used to increase the cash value and death benefit of the policy, reduce the premium, or be taken in cash. Dividends are not guaranteed and are paid at the discretion of the issuing company.

Summary: Long term death benefit protection, with a fixed premium and with opportunity for cash accumulation.

Survivorship Life

A life insurance policy designed to pay the death benefit at the time of the death of the second covered insured. These policies may be either whole life, universal life or variable universal life in design. The purpose of these policies is most often to provide the money to pay for the estate taxes due at the death of last surviving spouse of a couple with significant personal or business assets.

Summary: Long-term death benefit protection payable upon the second insured's death.