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Cash-Value or Term Insurance: Which Is Best for You?

The subject of insurance can be a confusing one; the myriad of options and possibilities are staggering. But, before you can answer these often-asked questions—How much do I need? How much will it cost? Will my beneficiaries have enough to live comfortably? —start with the basics. Do you need cash-value or term insurance?

Cash-Value Policies Extend the Possibilities

Cash-value life insurance, such as universal and whole life, combines a death benefit and a tax-deferred savings element. Occasionally referred to as permanent life insurance, this type of policy is intended to cover you for your lifetime.

Annual premiums for cash-value policies generally are higher initially than those of term policies. This is because part of each premium pays for insurance and the remainder is invested to build cash value. Cash value is what you can borrow from the policy or receive by surrendering it. The amount can build through professional investment management over the life of the policy. These funds are ideal for retirement planning because they accumulate tax-deferred until you withdraw them. Loans and withdrawals will reduce the policy's cash value and death benefit and may increase the chances that the policy will lapse.

Term Insurance Made Easy

Term insurance is the most fundamental type of life insurance. You purchase coverage for a designated period, from one to several years, and the policy will provide a death benefit if you die during that period. Many policies let you renew your coverage for repeated terms until age 65 or 70.

Term insurance is popular with younger people because it provides the maximum amount of coverage for the lowest cost. Early premiums are normally relatively low, but they increase considerably as you become older. For example, a $250,000 death benefit might cost less in your 30s than it will in your 50s. For this reason, term life insurance is usually a better value for shorter-term insurance needs.

The Decision Is Yours

Which type of policy is best for you? The answer depends on several factors, including:

Your needs. If you need coverage only until your teenage children graduate from college, for example, you might be better off with a term policy. Of course, you may want to purchase a cash-value policy and later surrender it. However, surrender charges might apply if you cancel the cash-value policy too soon (these charges decrease over time and eventually vanish).

Cash-value insurance is better suited for long-term needs, such as planning for estate taxes and providing lifetime security for your spouse. Some term policies cannot be renewed past age 70 and can become costly to renew as you approach that age.

The cost. If term insurance is more suited to your present expense plan and you want lifetime coverage, consider a term policy that may be converted into a cash-value policy. Then you can convert the policy whenever your cash flow or needs dictate. You also could purchase a combination of the two and gradually shift into cash-value insurance over time.

Your savings and investment goals. Cash-value life insurance can be a good long-term investment vehicle, especially because the cash value has the potential to grow tax-deferred. Should you no longer need the insurance but want some extra cash, you may surrender the policy and collect the accumulated cash value. Be sure to discuss the tax consequences with your tax advisor first.

As an alternative, you could purchase term insurance and invest what you save on premiums on your own. Compare the returns you can expect, and remember to take taxes into consideration if you plan to select taxable investments.

Term and cash-value life insurance both have advantages. Deciding which type of policy and which features are right for you takes careful consideration.

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