Life Insurance: Which Policy Is Best for You?

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People buy life insurance for different reasons, so it's no wonder that there are a variety of options from which to choose. But the differences among policies are not always clear. How do you decide between permanent and term life insurance? Which policies carry risk and which are guaranteed? And, when it's all said and done, which policy will cost most?

Fortunately, most life insurance policies have a few common features. For every policy, there is an *owner* who has all the rights associated with managing the policy. The owner decides who will be the *insured* (sometimes it is the owner) and who will be the *beneficiary*. The owner pays premiums to the insurance company. If the insured passes away while the policy is active, a sum of money called the *death benefit* is paid to the beneficiary.

Some policies have an *accumulated value*, which is everything you have paid in premiums after subtracting the cost of the insurance. The owner has access to this money. The accumulated value of the policy is sometimes called the *surrender value* because, if the owner decides to cancel (i.e., surrender) the policy, he or she gets back the current value of the account minus any applicable surrender charges.

Before you buy

Before you buy a policy, review a policy *illustration*. Illustrations show the structure of the policy and how it could change over time. They include in-depth charts that attempt to project, for each future year of the policy, the accumulated value, the premiums you will pay, and the death benefit you would receive. Illustrations are vital to deciding which policy to choose. But they're not the only piece of the puzzle to consider.

Permanent insurance and term insurance

The simplest classification of life insurance is whether it is permanent or term.

Permanent insurance has an accumulated value. Its goal is to protect against long-range or permanent needs. Many people use the policy's value to supplement retirement income or to transfer wealth at their death. Most permanent policies carry a surrender charge for a number of years, after which the owner can cancel the policy and reclaim its accumulated value. Provided that the premiums are paid, permanent insurance can offer a lifetime death benefit.

Term insurance can be described as a way to rent life insurance for an agreed-upon period. It is suited for short-term needs and can be used to provide coverage during the insured's working years, a child's early years, or for the duration of a loan or mortgage. Most insurance sold today is term life.

Term life insurance is very straightforward. There is no accumulated value and no interest, investing, or dividends. You simply pay the premiums for a certain length of time to be insured for a death benefit during that period. When the initial term expires, you can usually renew the policy annually by paying a premium that increases each year. You can also apply for a new policy, but your current health situation is a factor in the reapplication process.

Whole life insurance
Whole life is a permanent life insurance product. The insurance company guarantees a specific benefit upon death, no matter when it happens, as long as the required premiums are paid. Because whole life includes guaranteed accumulated values, the premiums are higher than for other insurance products. In addition, the premiums are mandatory; failure to pay a premium may result in a policy lapse and loss of the death benefit.

As premiums are paid, the accumulated value in the policy grows. With a whole life policy, you can also potentially receive dividends from the insurance company. Dividends depend upon the company's costs and investment performance that year.

Universal life insurance
Universal life is also a permanent life insurance product. The owner pays premiums that add to an accumulated value, and there is a death benefit if the insured dies. But, with universal life, premiums are flexible. The illustration indicates a suggested amount to pay in premiums, but the policy won't lapse if a payment is missed. Instead, the owner decides when and how much to pay in premiums.

When you look at a universal life policy illustration, you see projections of future accumulated values and death benefits for each year. Remember that the illustrated amounts are not guaranteed; projections are based upon current costs of insurance and current interest rates.

For this reason, one type of universal life is called *current assumption universal life*. You generally pay the suggested premium, with the goal of keeping the policy for life. Depending on interest rates, the accumulated value might grow more quickly or slowly than first projected.

Most universal life policies, however, offer a guaranteed death benefit. This is called *guaranteed universal life*, or *no-lapse universal life*. With these products, you must pay the premiums, as illustrated, to receive the death benefit.

Other types of life insurance
Indexed universal life policies guarantee a certain interest rate for the accumulated value of the policy. But they also provide the option to let the money in the policy accumulate based on the performance of a stock index. If the stock index goes down, the cash still grows at the guaranteed interest rate; if the index rises, the accumulated value grows at the index's rate of return (up to a certain limit).

So, which one do you need?
To find out which insurance product may work best for you, identify the reason that you want to buy life insurance. Most often, people buy life insurance to replace the income of the insured. Others purchase a policy to cover the many costs associated with death. Finally, besides being a way to replace income or pay off debts, life insurance can serve as a vehicle for saving and investment.

Guarantees are based on the claims-paying ability of the issuer.

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