

Types of Life Insurance Policies



You know that you need life insurance. However, with the wide variety of insurance policies available, you may find choosing the right one difficult. It's really not as confusing as it seems, however, once you understand the basic types of life insurance policies.

Term life insurance

With a term policy, you get "pure" life insurance coverage. Term insurance provides a death benefit for only a specific period of time. If you die during the coverage period, your beneficiary (the person you named to collect the insurance proceeds) receives the death benefit (the face amount of the policy). If you live past the term period, your coverage ends, and you get nothing back. Term insurance is available for periods ranging from 1 year to 30 years or more. You may be able to renew the policy for a new term without regard to your health, but at a higher rate. Your premium goes toward administrative expenses, company profit, and a reserve account that pays claims to those who die during the term period. As you get older, the chance that you will die increases. To cover this increasing risk, your premiums will likewise rise at regular intervals. For this reason, premiums that were quite inexpensive at the time you initially purchased your term policy will become much more expensive as you get older. Most term insurance also has a conversion feature that allows you to switch your coverage to some type of permanent insurance without answering health questions.

Traditional whole life insurance--guaranteed premiums

Whole life insurance is a type of permanent insurance or cash value insurance. Unlike term insurance, which provides coverage for a particular period of time, permanent insurance provides coverage for your entire life. When you make premium payments, you pay more than is needed to pay for the current costs of insurance coverage and expenses. The excess payment is credited to a cash value account. This cash value account allows the insurance company to charge a level, guaranteed premium* and to provide a death benefit and cash value throughout the life of the policy. As you make payments, the cash value account grows. With traditional whole life insurance, the cash value account is guaranteed* and held in the insurance company's general portfolio--you don't get to choose how the cash value account is invested. However, the cash value can potentially grow beyond its guaranteed amount through the payment of dividends (profits earned by a "mutual" insurer). The cash value grows tax deferred and can either be used as collateral to borrow from the insurance company or be directly accessed through a partial or complete surrender of the policy. It is important to note, however, that a policy loan or partial surrender will reduce the policy's death benefit, and a complete surrender will terminate coverage altogether. If you live to the policy's maturity date, the policy will "endow," and the insurance company will pay the accumulated cash value (equal at maturity to the death benefit) to you.

Universal life--openness and flexibility

Universal life is another type of permanent life insurance with a death benefit and a cash value account. Like whole life insurance, the cash value is held in the insurance company's general portfolio--you don't get to choose how the account is invested. Unlike traditional whole life, universal life insurance allows you flexibility in making premium payments. A universal life insurance policy will generally provide very broad premium guidelines (i.e., minimum and maximum premium payments), but within these guidelines you can choose how much and when you pay premiums. Reducing or increasing premiums will impact the growth of the cash value component and possibly the death benefit. You are also free to change the policy's death benefit directly (again, within the limits set out by the policy) as your financial circumstances change. Be aware, however, that if you want to raise the amount of coverage, you'll need to go through the insurability process again, probably including a new medical exam, and your premiums will increase. Universal life policies reveal all aspects of the policy's cost structure, including the cost of insurance (the portion set aside to pay claims) and expenses. This information is not always available with other types of policies. Another feature of universal life is the option to add the cash value to the face amount when the death benefit is paid. For example, say you die when you have \$200,000 of cash value within your \$1 million policy. If you chose the enhanced benefit option, your beneficiary receives \$1.2 million. Keep in mind, however, that nothing is free--the increased benefit is reflected in premium calculations. Index universal life is a type of universal life insurance. Index universal life insurance credits interest based on the performance of an equity index, such as the S&P 500.

Variable life--you make the investment decisions

Like other types of permanent life insurance, variable life insurance has a cash value account. A variable life insurance policy, however, allows you to choose how your cash value account is invested. A variable life policy generally contains several investment options, known as subaccounts, that are professionally managed to pursue a stated investment objective. Choices can range from a fixed interest subaccount to a highly volatile international growth subaccount. Variable life insurance policies require a fixed annual premium for the life of the policy and may provide a minimum guaranteed death benefit*. If the cash value account exceeds a certain amount, the death benefit will increase.

Variable universal life--the ultimate in flexibility

Variable universal life combines all of the options and flexibility of universal life with the investment choices of a variable policy. It is a true hybrid product, and you make most of the policy decisions. You decide how often and how much your premium payments are to be, within guidelines. With most variable universal life policies, you get no guaranteed minimum cash value or death benefit. Your premium payments in excess of administrative costs and the cost of insurance are invested in the variable subaccounts that you choose. As with both variable and universal life insurance, your policy may lapse if the cash value account falls below a certain level. Low-interest loans can be taken against your cash value account, and cash withdrawals are available. However, keep in mind that your policy's face amount is reduced by the amount of a policy withdrawal, and withdrawals may be taxable. You have the option of choosing a fixed or enhanced death benefit. Today, most variable universal life policies offer a rider that guarantees the death benefit at a certain level regardless of the performance of the subaccounts, provided that a stated minimum premium is paid for a predetermined number of years*.

Note: *Variable life and variable universal life insurance policies are offered by prospectus, which you can obtain from your financial professional or the insurance company. The prospectus contains detailed information about investment objectives, risks, charges, and expenses. You should read the prospectus and consider this information carefully before purchasing a variable life or variable universal life insurance policy.*

*Any guarantees associated with payment of death benefits, income options, or rates of return are subject to the claims-paying ability of the insurer.

Joint or survivorship life for you and your spouse

Some married couples choose to buy insurance together within the same policy. These policies take the form of either a joint first-to-die or a joint second-to-die (survivorship) design. With first-to-die, the death benefit is paid at the death of the spouse who dies first. With second-to-die, no death benefit is paid until both spouses are deceased. Second-to-die policies are commonly used in estate planning to create a pool of funds to pay estate taxes and other expenses due at the death of the second spouse. Joint and survivorship policies are generally available under any type of permanent life insurance. Other than the fact that two people are insured under one policy, the policy characteristics remain the same.