A Short Course in Insurance

Permanent vs. Term

When choosing **life insurance** coverage, you may wonder which type is more appropriate for your situation. During life stages, you will probably review and update your insurance coverage, as your needs change. There are two basic types of coverage—**permanent** (sometimes referred to as **cash value**) and **term life insurance**. Let's take a closer look at the short- and long-term benefits of each.

Permanent Life Insurance

Permanent life insurance helps provide financial security for surviving loved ones upon the death of the insured, and also builds cash value for the policyholder. Premium payments first pay the cost of the policy coverage, including the expenses and mortality factors of the insurance company. Then, the insurance company invests any remaining amount in order to build the cash value of the policy. Permanent life insurance combines protection with cash value as assets and earnings accumulate over the life of the policy, and the policyholder can generally access these funds for any purpose.

Some permanent policies provide policyholders with nonguaranteed **dividends**, which are the result of favorable mortality experience, investment results and expense savings that result in a surplus for the insuring company. Dividends can be taken in cash or used to pay future premiums or to purchase additional life insurance coverage, but are not guaranteed.

Premium amounts for permanent insurance will not change as long as they are paid in accordance with the schedule set forth in the policy. Payments continue for a predetermined period, as chosen by the policyholder. The length of the payment period and the amount of coverage will affect the premium cost. Permanent life insurance protection is guaranteed, which means that as long as premiums are paid on time, the insured is guaranteed coverage for life in accordance with the terms of the policy. Guarantees are based upon the claims-paying ability of the policy issuer. Evidence of insurability will never be necessary as long as the original policy remains in force, and benefits will never decrease.

As for the cash value component of permanent life insurance, funds may be borrowed against the cash value of the policy at a predetermined loan interest rate. No repayment schedule is set beyond regular payment of interest on the loan, with outstanding loan balances deducted from the death benefit. These loans are generally tax free, and there are no restrictions on their use. Access to cash values through borrowing or partial surrenders can reduce the policy's cash value and death benefit, increase the chance that the policy will lapse, and possibly result in a tax liability if the policy terminates before the death of the insured.

Term Life Insurance

In a term life insurance policy, there are three basics to consider: 1) The period of protection is for a predetermined, specified term; 2) policies do not accumulate cash values like permanent insurance; and 3) premiums may initially be lower than permanent life insurance premiums, but will rise over time as set forth in the policy document.

Nonrenewable, nonconvertible term insurance for one, five, or 10 years may provide the most affordable protection, especially for those who require coverage to back a business loan, cover the cost of a mortgage, protect minor children, etc. Premiums will, however, increase over the period of protection. Term insurance is also available for longer durations (e.g., to age 95), but increasing premiums may result in higher overall costs than permanent life insurance over the long term.

Term insurance may be ideal to help cover a specific need, such as an outstanding mortgage. These needs can be met by purchasing coverage for a specified period of time and at the lowest premium cost. In fact, many companies offer decreasing term insurance in which the value of the death benefit decreases over time, as in the case of covering a decreasing mortgage balance.

Which Product and When?

Life insurance serves many purposes. When determining an appropriate amount of coverage, it is important to consider your short- and long-term goals, current financial status, and what you can afford. A thorough review of your needs with a qualified professional can help you choose a suitable policy for your situation.

Note: Life insurance policies contain exclusions, limitations, reductions of benefits, and terms for keeping them in force. Your financial professional can provide you with costs and complete details.

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