LIFE INSURANCE – Main Differences Between Term and Cash Value

TERM LIFE INSURANCE – The three basic types include Annually Increasing Premium, Level Premium, and Decreasing Premium. These can be individual or group policies.

1) Term is generally more affordable in the short run (e.g., < 20 yrs) than Cash Value. It is particularly useful for those who intend to purchase a business, and those with annual incomes of less than $100,000. Initially, premiums for Term insurance are 5 to 15 times less expensive than properly funded Cash Value policies.

2) Term is usually sufficient to satisfy the most common need for life insurance; the "critical" period when a spouse or children are dependent upon your income.

3) Term is simpler to understand than Cash Value coverage.

Note: Of the basic types of Term insurance, Level Premium Term typically provides the best value in terms of guarantees and premiums. It is also the most common form of individual Term insurance. The benefits typically remain the same even though the premiums may change.. Decreasing Term is typically expensive for what you get and benefits in many cases decrease over time. It is often sold along with home mortgages. Group coverage can be good but is often more expensive than individual coverage, particularly for relatively healthy individuals and when comparing premiums over the term period. In addition, group policies typically lack the portability and guarantees that individual policies provide. There may be other specialty term products in existence, like Accidental Death Coverage, but these policies are very limited in scope and value.

CASH VALUE LIFE INSURANCE – Cash Value policies are like Term policies with an investment account added. The three basic types include Whole Life, Universal Life, and Variable Life. Most are individual policies.

1) Cash Value is generally more affordable in the long run (e.g., > 20 yrs). It is effectively the only way to keep life insurance coverage into older ages when you may care more about it. If you were disciplined enough, you could put money in a side fund to pay future premiums on a Term policy. However, the cost of insurance on Term policies at older ages tends to be prohibitive, most end at some point, and it may be difficult to find an investment with good enough risk/reward characteristics and tax advantages to outweigh the performance of a good cash value policy.

2) Cash Value is more likely to pay a death benefit and the only way to guarantee lifetime coverage With it, you can rest assured that your heirs or favorite charity will not be left empty-handed, and be confident that your estate plan is funded properly, no matter when you die. It is usually the policy of choice in estate planning. However, not all Cash Value policies "guarantee" lifetime coverage or work as intended. If they are misunderstood or improperly used or structured, they could become unaffordable and lapse.

3) Cash Value policies are very flexible financial instruments, and can be very efficient. Cash grows tax deferred and can be withdrawn tax free when properly funded and structured. Unlike most investments, cash value life can provide instant leverage and protection without sacrificing much or any efficiency, and can be favorable to or complimentary with other investments. The ability to optimize retirement cash flows can be enhanced with cash value coverage. Options like flexible premiums, increasing death benefits, and a variety of "riders" provide numerous other planning possibilities.

Note: Within Cash Value policies, Whole Life typically has more Guarantees. Universal Life has Flexible Premiums, meaning you can pay different amounts, skip a payment, etc. Variable life can be a type of Whole or Universal Life policy that allows you to direct the cash into in a variety of investments, through accounts that resemble mutual funds. There are also Indexed Life policies which are a cross between Universal Life and Variable policies. The cash growth in Variable Life depends on how well your investments perform, whereas the cash growth in Universal Life and Whole Life policies depend upon the investments of the insurance company, which are typically more conservative and stable.

THINGS TO CONSIDER - The amount of insurance desired, the length of time coverage is desired, your cash flow now and in the future (affordability), and other efficient uses of your money (retirement plans, purchasing businesses, etc). The amount of coverage rather than the type of policy you choose, is the usually the most important initial decision. Then, the decision of how long you will maintain coverage and affordability can help steer you in the right direction. Also consider a combination of both types of policies.

If you are unsure about what benefits and type to get, call us. We are here to help you in your efforts to find not only the policy type that's right for you, but the most competitive and efficient policies from quality companies. Note also that you can usually start out with Term and "convert" to Cash Value within the same company, without having to re-qualify medically. The costs will likely be higher by starting your Cash Value policy later (due to age), but this method is sensible, affordable, and can provide the protection you need.