

Types of life insurance: advantages and disadvantages



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Overview

Life insurance is one of the most popular types of insurance that people purchase. Life insurance is basically insurance that you purchase and will pay money to your beneficiaries if you die. One of the main reasons why people purchase life insurance is to protect their family financially. Life insurance will help pay for burial costs, debt, mortgages, and any other income losses that will occur if someone dies. Life insurance is paid for just like automotive insurance is. It can be paid by a monthly, quarterly, or annually premium for as long as the policy goes for (Types of Insurance Policies, 2011). There are several different types of life insurance policies that people can purchase that will best suit their needs. The main types are term life insurance, whole life insurance, variable life insurance, and universal life insurance. In this research paper, I will explain the advantages, disadvantages, time lengths, and how each of the types of life insurance fit different people.

It is very important to understand how these insurance companies calculate premiums for different people. Their main goal is to assess the risk of

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someone dying during the policy. Just like other types of insurance, the more risk you have, the higher your premium will be. Some of the factors that are used to determine premiums are gender, age, occupation, height, weight, medical history, lifestyle, and if you smoke (Types of Insurance Policies, 2011). Recently I had to do a project in class where you had to find different premiums on life insurance. Some other things that I was asked were if I recently had any DUIs, if any relatives have died before the age of 60, if I have recently been hospitalized, and if any diseases run in my family. All of these factors do give the insurance companies a better understanding of someone's risk, but it is nearly impossible to be able to determine the chances of someone passing away. It is also difficult to estimate the cost of each of the different types of life insurance because it is different for every individual.

Term life insurance is very affordable, and that is why it is growing in popularity. Term life insurance is basically a life insurance policy that covers a person if they die during the length of their insurance. Term life insurance policies can be anywhere from 1 to 30 years. These policies are known as "temporary" because once the policies are over, you are no longer covered. For example, if you purchase a 10 year term life insurance policy, and you die the year after your policy expires, your beneficiaries won't receive any money. This also means that if you stop paying your premiums, you will no longer be covered.

There are many different reasons how people decided on how long they want their life insurance policy to cover their family. A lot people that purchase term life insurance decide to make their contract until they retire. Another <https://assignbuster.com/types-of-life-insurance-advantages-and-disadvantages/>

popular way people decide on their term is to remain covered until their children have turned 18. This is a very smart way to insure that your children will be financially protected until they are adults (Life Insurance Wiz, 2006). Another good reason to purchase term life insurance is if you are involved in risky or potentially fatal activities. Even though these factors will increase your premium, it is still worth it in case something terrible happens. The cost of term life insurance all depends on a person's risk and the length of the policy.

There are several different types of term life insurance, and it is important to know the differences when selecting the best type. Annual renewable term life insurance means that each year a person may renew their term life insurance. However, each year you renew your term life insurance, the premium will go up in cost because of your age. Renewable term life insurance means that after your specific term is up, you are allowed sign a new term life insurance contract. Level premium term insurance means that your premium will not change throughout the length of the contract. This type of term insurance is good because as you get older, you don't have to pay more money for your life insurance. Convertible term insurance means that you are allowed to convert your term insurance into another type of life insurance, like universal or whole life (Life Insurance Wiz, 2006).

There are advantages and disadvantages to term life insurance. Some advantages are that you get to choose how long you want to be covered for, most policies can be changed or renewed to other policies, and your beneficiaries are paid a specific amount upon your death which is decided when you start your policy. Some disadvantages are that if you pass away <https://assignbuster.com/types-of-life-insurance-advantages-and-disadvantages/>

after your term life insurance policy, no benefits are given to your family, and it doesn't offer as much protection as other life insurance policies offer (Life Insurance Wiz, 2006).

Whole Life Insurance

Whole life insurance is exactly what it sounds like, a life insurance policy that lasts for someone's whole life. Upon death, the beneficiary receives the value of the account. Whole life insurance is also known as permanent life insurance. The main difference between whole life and term life is that whole life insurance grows in value over time. Whole life insurance is similar to a retirement account where you are putting money toward the future, except in this case it is toward your death. An interesting fact about whole life insurance is that you can actually borrow money out of your account, which you cannot do with term insurance (Life Insurance Wiz, 2006). To be able to borrow money out of your account, there must be a set minimum of money already invested into the account. Most whole life insurance policies mature when a person turns 100 years old, so if that person is still alive they will receive the face value of their account (My Life Insured, 2007). The main reason why people choose whole life insurance over term life insurance is because they want to be insured for the rest of their life. For this reason, whole life insurance is more expensive than term insurance.

There are several different types of whole life insurance. Non-participating whole life insurance means that you do not receive dividends for your policy.

On the other hand, participating whole life insurance means that you do receive dividends. Level premium whole life insurance is just like level term

insurance, where you pay the same premium throughout the length of the <https://assignbuster.com/types-of-life-insurance-advantages-and-disadvantages/>

policy. Purchasing a life insurance policy with a fixed premium is a great choice because once you retire, you wouldn't want your premium to increase every year due to the loss in income. Single premium whole life insurance is a policy where you pay a large sum of money in the beginning of your policy, which then eliminates having to pay premiums. This type of policy is not very popular due to the reason that you would need a lot of money up front. Intermediate whole life insurance means that your premiums change over time depending on your status (New York State Insurance Department, 2011). In the past couple years, a significant amount of people lost their homes because of adjustable mortgages, so I think that this type of whole life insurance is not a good choice.

Some advantages of Whole life insurance are that they are usually fixed premiums, the beneficiaries will receive money whenever the policy holder dies, there are tax benefits, and most of the money will be returned if the policy is cancelled. The money that accumulates in your policy is tax free, which attracts a lot of people to purchase a whole life insurance policy over a term life insurance policy. Some disadvantages of whole life insurance is that it is costly compared to term insurance, and it is much more complicated than term life insurance (New York State Insurance Department, 2011). If you are interested in purchasing a whole life insurance policy, it is important to know which type it is so you know you will be able to afford it for the rest of your life.

Universal Life Insurance

Universal life insurance is very similar to whole life insurance. A universal life insurance policy will cover someone for their whole life, so it is also <https://assignbuster.com/types-of-life-insurance-advantages-and-disadvantages/>

considered a permanent life insurance policy. Universal life insurance policies also grow in cash over time, which is tax deferred. The interest rates increase and decrease like the money market, so there is a chance to make a lot of money in this type of life insurance (My Life Insured, 2007). The main advantage that universal life insurance has over whole life insurance is that there is more flexibility in the policy. The cash value and the death benefits parts of your policy are broken up, so a person can decide how much of their money will go in each part (Life Insurance Wiz, 2006). The policy holder can also increase and decrease their premium depending on their situation. However, the insurance companies do have a target premium, so if you pay less than it, you may be penalized (Life Insurance Wiz, 2006). This type of life insurance policy would be best for someone who wanted to be covered for the rest of their life, and would want to be able to adjust their policy to be suit their needs.

Advantages of Universal life insurance are it is the most flexible, you are able to take out loans, you can adjust your premiums due to your situation, and the cash you earn in interest can be used toward your payments. Some disadvantages are that your cash value isn't guaranteed like it is with whole life insurance and it more costly than term and universal life insurance policies (Life Insurance Info, 2011).

Variable Life Insurance

Variable life insurance is also considered a permanent type of life insurance. It is considered a " pure investment policy" because the insured has completed control of how their money is invested (My Life Insured, 2007).

They can decide to invest their cash account into bonds, stocks, or any other
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money market funds (My Life Insured, 2007). For this reason, variable life insurance is the most risky out of all the types of life insurance. If a person makes poor investment choices, they risk losing a substantial amount of their money. On the other hand, if good investments are made, the policy holder can receive a significant profit. Due to the risk of this type of life insurance, it is the most expensive one. This type of life insurance policy is only a good choice for people that understand the money market, and will remain active in watching their investments.