Yes Virginia, There Are Different Types of Life Insurance

Different types of life insurance policies are available to meet individual estate planning requirements, which can change over time. Understanding how the various life insurance products work can help you develop a flexible estate plan that is right for you.

Term Insurance

Many people start out with a term insurance policy to provide an income replacement source for survivors if death occurs within the period of time covered by the policy. Term insurance has a guaranteed death benefit but creates no cash value during the policy's life. Term policy premiums are based on mortality tables and may either gradually increase or be fixed for a period of time, after which the premium may increase sharply. Some people buy differing amounts of level premium term insurance for varying time periods. Because of rising premium costs, the insured may choose to cancel a term life insurance policy at a later date if he or she does not have a life threatening illness and determines that the costs outweigh the potential benefits.

Whole Life Insurance

In whole life insurance policies, the premium always remains level. The original face amount is guaranteed, and after the first year or two the cash value of the policy increases annually. The insurance company sets aside a portion of the premium each year as a cash reserve. The insured's mortality risk, which increases as he or she ages, is offset by the reserve. When the policy matures (such as at age 100), the cash value will often equal the original face amount. Fortunately for the insured, the actual cash value and death benefit of the policy can greatly exceed the guaranteed amounts because of the payment of dividends.

Dividends are not guaranteed, but can form an important component of whole life policies. Like stock dividends that the owner of common stock would receive, the insured can receive insurance policy dividends in the form of cash. Many people choose, however, to use the dividends to purchase additional amounts of life insurance. This additional coverage also has a cash value and death benefit.

An alternative is to use the dividends to offset premiums. The dividends may eventually be sufficient to pay the entire current premium, so that there is no out-of-pocket cost to the policy owner. The premiums may, however, need to be paid out of pocket any time the dividends are insufficient to support the premium that is then due. Projections that illustrate the ability of the dividends to pay future premiums are simply estimates and are not guaranteed. Although some insurance companies have a good track record of meeting or exceeding their projections, the projections may sometimes be too optimistic.

The ability to use dividends to pay all of the premiums under a whole life policy should not be confused with a paid-up insurance policy. A paid-up policy remains in force even if no further premiums are paid by the insured or from dividends. This is accomplished when the cash value of the policy is sufficient to ensure that all future premiums will be paid.

Universal Life Insurance

Universal life insurance may function like term insurance or like whole life, depending on funding levels and performance. Universal life insurance generally is initially less expensive than whole life because the insured shares some of the risk taken by the insurance company. The death benefit is often not guaranteed beyond a period of 10 to 20 years. The cash value is not guaranteed to match the death benefit at the maturity of the policy.

A major distinction between whole life and universal life is the economic risk associated with universal life. If the interest rate and mortality costs are worse than the insurance company has projected, then the cash value of the universal life policy can be quickly consumed and the insured will essentially be left with a term life insurance policy. The result can be that coverage will expire unless the insured pays very large premiums. In the best case scenario, the cash value in the policy earns a sufficient amount to pay the increasing premium cost and to grow without any reduction of principal.

Variable Life Insurance

Variable life insurance usually involves universal life insurance and includes a feature whereby the policy's cash value is invested in the stock market. The benefits as well as the risks associated with regular universal policies are magnified by the potential volatility of the stock market.

What Policy Is Right for You?

When purchasing life insurance, consider each of the available types of life insurance to determine which policy will best serve your estate plan. You may use them in a variety of ways, including purchasing second-to-die life insurance. Look to us for answers to any of your life insurance and estate planning questions.

A Note About Second-To-Die Insurance

Second-to-die insurance is designed to provide liquidity to pay estate taxes upon a family member's death. Essentially, it is a policy that insures the lives of two people rather than one. It features a number of additional advantages:

- The premiums are lower,
- The estate administrative costs are lower, and
- Uninsurable parties can be covered.

As with all other types of insurance policies, your specific situation will determine whether second-to-die insurance will work for you. Setting up an irrevocable life insurance trust as policy owner and beneficiary could make this possible. Feel free to contact us with any questions you have about this or any other type of insurance.