How to Buy Life Insurance

Life insurance is primarily a product for families. If you have a spouse and children who depend on your income and you don't have extensive resources, then life insurance is a useful tool to help them pay expenses. Single people without dependents typically don't need the same amount of life insurance because they don't have as many responsibilities that will outlive them.

Most financial planners would tell you that insurance is not a replacement for a long-term savings or investing strategy but an additional cushion. Depending on your financial situation, life insurance and its ancillary products can have some very attractive tax characteristics as well.

Who needs life insurance: Those with dependents, either children or friends or family members with special needs; with a nonworking spouse or one with an income substantially lower than yours or those with a big mortgage that will be too overwhelming for one income to pay off.

How much is necessary: Optimally, the right amount of life insurance allows your survivors to invest the insurance payout and then draw down the account over time in a way that matches the income you would provide if you were still around. You need to figure far more than a family's basic living expenses adjusted for inflation. Also consider:

- Education funds needed for each child from grade school to college.
- Money to cover special health expenses for a family member already diagnosed at the time of the insured's death.
- Funds for child care if the surviving spouse needs to keep working.
- Emergency funds that your survivors can keep in reserve.

Types of life insurance: There are six basic types of life insurance.

- *Term:* Term life insurance is the simplest kind of life insurance because it pays if death occurs during the term of the policy, which is usually from one to 30 years. There are two kinds of term life insurance: <u>Level term</u> means that the death benefit stays throughout the duration of the policy, and <u>decreasing term</u> means that the death benefit drops in one-year increments over the duration of the policy.
- *Whole life/permanent:* Whole life or permanent insurance has a level premium and pays a static benefit whenever you die. For this guaranteed benefit, whole life is usually the more expensive choice because it front-loads its costs into the early premium years of the policy so it can invest the money to pay for death benefits at the end of several years or decades. At a certain point, the policy owner will pay in enough where he or she will start accruing cash value on that money which can be withdrawn if the policy owner decides to cancel the coverage. There are four types of permanent insurance:
- *Whole or ordinary life:* This is the most common type of permanent insurance policy, offering a death benefit with a savings account. You agree to pay a certain amount in premiums on a regular basis for a specific death benefit. The savings element would grow based on dividends the company pays to you.

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- *Universal or adjustable life:* This variation offers a little more flexibility, such as the possibility of increasing the death benefit if you pass a medical exam. The savings product attached to this kind of account generally earns a money market rate of interest, and after you start accumulating money in this account you'll generally have the option of altering your premium payments. This helps if you lose your job or have some other financial misfortune.
- *Variable life:* This policy lets you invest your cash value in stocks, bonds and money market mutual funds which is good if those investments go up. If they go down, your cash value and death benefit will shrink, but you need to make sure there's a guarantee that your death benefit won't fall below a certain level. This type of policy can be fairly risky for ordinary consumers.
- *Variable-universal life:* This choice allows you the flexibility of premium payments with a more aggressive investment scenario for the cash value of the policy.

Life insurance proceeds don't generally go into Uncle Sam's collection plate, which makes life insurance an attractive purchase for many individuals hoping to maximize the amount to give to heirs. Yet life insurance can also be purchased in a way to give the living policyholder tax-free income during retirement. Since we're talking about estate issues here, getting proper advice is critically important. The federal government's current estate tax ceilings were set to expire in 2010, and this fact alone could affect the attractiveness of this strategy for your situation.

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This column is produced by the Financial Planning Association, the membership organization for the financial planning community, and is provided by Angel McCall, CFP, a local member of FPA. You will find additional informative articles at www.AngelMcCallCFP.com .