

# Life Insurance: The Different Types of Policies

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## Life Insurance Overview

A life insurance policy provides a cash payment when a person dies. This payment is known as the **death benefit**. Many people buy life insurance to protect the people who are dependent on them. Others buy life insurance as a way to leave a cash gift to their spouse, children, grandchildren, and charities at their death. If you have made the decision to buy a policy, you may wonder which type of policy to choose since there are several different types of policies.

The policy is written on the life of a person, known as the **insured**. The **owner** makes payments, known as **premiums**, to the insurance company for the policy. In return, the insurance company agrees to pay the death benefit to the **beneficiary** if the insured dies within the stated term.

## Term

Term insurance is the most basic type of life insurance. The policy is written for the term of the policy, usually from one to 30 years. If the insured dies within the stated term, the insurance company pays the death benefit to the beneficiary. When the term ends, the insurance ends. The premiums for term insurance are usually the lowest among the different types of life insurance, but will increase with the age of the insured. There is no **cash value** in a term life policy. (Cash value will be discussed in greater detail later.) This means there is no money for loans or to pay for the insurance if you can't pay the premiums.

Many employers offer a type of term insurance known as “group” term to their workers. Group policies cost less, and many companies pay the premiums. Generally, the policy is only good for as long as the worker stays with the company.

Term insurance is suggested for those who only need the death benefit for a certain period of time. See *Life Insurance: Term Insurance*, Virginia Cooperative Extension publication 354-144, for more information on term insurance.

## Whole-Life

A whole-life policy pays a death benefit no matter when the insured dies. In most cases, the policy will guarantee the death benefit. The premiums are usually much higher than a term policy and the full premium *must* be paid each year. Whole-life policies have cash value. The difference between the premium and the actual cost of the insurance is put into a special account, known as the cash-value account. This cash-value account may be used to help the insured pay the “fixed” premium payments in later years. The policy owner may borrow against the cash value or receive the cash value if the policy is canceled. There may be charges associated with borrowing against the cash value or canceling the policy before the death of the insured. The insurance company may charge interest if the money is borrowed and fees to close out the account if the policy is canceled. **At death, the beneficiary only receives the death benefit, not the death benefit and the cash value.**

Whole-life works well for those who want a guaranteed death benefit no matter how long the insured lives, and who have enough money to pay the premiums. See *Life Insurance: Whole-Life Insurance*, Virginia Cooperative Extension publication 354-145, for more information on whole life.

## Universal-Life

A universal-life policy is similar to a whole-life policy. However, a universal-life policy gives the policy owner the choice of changing the premium and even the death benefit.

For example, the owner may decide to double the premium paid one year. The extra money will go in the cash-value account. Most universal life policies have cash-value accounts that pay at least 3 percent or 4 percent interest. Another year, the owner may decide not to pay any premium, and use money in the cash-value account to pay the costs for that year. Policy owners may have a higher death benefit while their children are young, and a lower the death benefit once their children are grown.

There are some limits to the changes that can be made. The policy owner needs to be careful not to pay too little, and end up with no cash value. If this happens, and the owner still wants the insurance, he or she will need to buy a new policy. **Some policies allow the beneficiary to receive both the death benefit and the cash-value account at the death of the insured. Be sure to read the policy closely as some only pay the death benefit.**

Universal-life works well for people who want lifetime coverage with added flexibility. See *Life Insurance: Universal-Life Insurance*, Virginia Cooperative Extension publication 354-146, for more information on universal life.

## Variable Universal-Life

A variable universal-life policy is a special type of universal policy. It allows the cash-value account to be invested in stock funds, bond funds, and other assets (much like mutual funds). These funds may allow the cash value to grow at higher rates than fixed-rate whole-life or universal-life policies. The down side is that these funds may also have losses. Many variable policies also offer a fixed account with a low guaranteed interest rate as one of the options. If the returns are low (or negative) then the owner may need to pay more premiums to keep the policy.

A variable universal-life policy is for people who want lifetime coverage, and who can tolerate risk. The buyer of a variable universal-life policy would prefer to invest money in stocks and bonds to safer assets. See *Life Insurance: Variable Universal-Life Insurance*, Virginia Cooperative Extension publication 354-147, for more information on variable life.

<b>Insurance Type</b>	<b>Premiums</b>	<b>Cash Value</b>	<b>Lifetime Coverage?</b>	<b>Best For...</b>
<b>Term</b>	Usually lowest	No	No – some policies can be renewed, but at higher costs.	People who only need insurance for a limited time
<b>Whole</b>	Usually higher than term in early years, but lower than term in later years of the policy	Yes – general account of insurance company (Long-term bonds and mortgages)	Yes	People who want guaranteed lifetime insurance
<b>Universal</b>	Premiums could be higher or lower than whole-life depending on how much is desired in cash value	Yes – general account of insurance company (Short-term money market)	Yes – but depending on the premium level, there may be a risk that policy will lapse	People who want lifetime insurance, but with added flexibility
<b>Variable Universal</b>	Premiums could be higher or lower than whole-life depending on how much is desired in cash value, and the actual rates of return	Yes – stock funds, bond funds, other assets	Yes – but depending on the premium level, there may be a higher risk that policy will lapse	People who want lifetime insurance, but who tolerate risk and prefer to invest in equity assets over safer assets

## Definitions of Terms

**Beneficiary** – The person or entity receiving the death benefit at the death of the insured.

**Cash Value** – The amount of total premiums paid for a policy minus the costs for insurance in whole-, universal-, and variable universal-life policies. The cash value grows tax-free in an insurance policy.

**Death Benefit** – The total cash payment made to the beneficiary upon the death of the insured.

**Insured** – The person on whose life the insurance has been purchased. If the insured dies, a death benefit will be paid to the named beneficiary.

**Owner** – The person or entity who owns the insurance policy. The owner may or may not be the insured. The owner can designate the beneficiary, and is responsible for paying premiums. See *Life Insurance: The Impact of Ownership*, Virginia Cooperative Extension publication 354-142, for more information on the impact of ownership.

**Premium** – The amount billed to the owner of an insurance policy (usually monthly, quarterly, or annually) by the insurance company. In term and whole-life, the full premium must be paid to keep the insurance. In universal- and variable universal-life, the amount billed may or may not be a mandatory payment to keep the insurance.

## Other Sources

You can find more information on the different types of life insurance policies at Life and Health Insurance Foundation for Education (<http://www.life-line.org>), the American Council of Life Insurers (<http://www.acli.com>), and the Insurance Information Institute (<http://www.iii.org>).

## Reference

Baldwin, B.G. (2002). *The new life insurance investment advisor, second edition*. New York: McGraw Hill.