

What type of life insurance policy is best for you?

By Peter Murphy

Last month I described the reasons why people purchase life insurance. In this article I will discuss the different types of life insurance policies available, along with their benefits and limitations.

Without considering combinations, there are five major types of life insurance policies available: Term, Whole, Universal, Variable and Indexed Life policies. Each category varies in cost, growth potential, use and flexibility.

Term insurance is limited to a specific period of coverage. This can be as short at one year or as long as thirty years depending on the insured's age. Premiums for term insurance can increase, or remain constant over the period of coverage depending on a policy owner's preference to leave the death benefit at a constant level or reduce the death benefit with age. This type of insurance is initially the least expensive. It doesn't build cash value within the policy and is not guaranteed through life expectancy.

Whole Life is a level premium, permanent insurance contract which covers an insured's lifetime. Unlike term insurance, cash value builds within a whole life policy. A portion of the cash value is available in the form of tax-free loans, however, loans reduce the death benefit, and if the policy is surrendered or lapses, there may be significant tax consequences. This type of insurance is generally more expensive, since the cash value growth rate and the death benefit are guaranteed for life.

Universal Life was developed from whole life insurance to provide flexibility and increased cash value earning potential. Premiums can be increased, decreased or deferred, and the policy owner has the option, for an additional charge, to receive the cash value in addition to the stated death benefit. Universal life guarantees a minimum rate of return on policy cash value, however, higher rates of return are often assumed. If the rate of return expectation isn't realized, the policy owner may need to increase premiums or lower the death benefit to keep the insurance contract from lapsing. Partial withdrawals and loans are allowed within universal life policies.

Variable Life is similar to a whole life policy with a level premium and minimum guaranteed death benefit. This type of permanent insurance permits policy owners to allocate a portion of each premium payment into separate accounts, which are distinct from an insurance company's general account. Investment options within these separate accounts include stocks, bonds and money market funds. Compared to other life insurance policies, variable life has the greatest opportunity to build cash value, but, contains significant potential to lose cash value during market downturns. If the assumed rate of cash value growth isn't realized, the policy may require increased premiums or the policy may lapse.

Indexed Life is a form of permanent life insurance, with a minimum guaranteed return on its cash value. Policy owners may allocate a portion of each premium into an equity indexed strategy, where gains are determined by the performance of a stock market index. If the index performs well, then cash value will appreciate according to a predetermined formula. If the index performs poorly, the cash value is protected against loss by the same predetermined formula. Indexed life policies' potential for increased gains combined with a guaranteed minimum return on cash value make indexed life very attractive for some policy owners when compared to variable life, universal life and whole life insurance policies.

Have you maximized your qualified retirement plan investment contributions and desire another option to increase retirement wealth? Insurance policies offer owners the choice to supplement retirement income and/or meet unplanned life emergencies through access to life insurance policy cash values. This income is available through tax free withdrawals up to your basis in the contract or by policy loans. Insurance policy cash values are protected from creditors and lawsuits in New Mexico if the beneficiary is a New Mexico state resident. Life insurance can diversify your retirement portfolio by creating a policy designed to produce a retirement income stream as a non-qualified deferred compensation plan. Armed with knowledge, you will be better prepared in considering which policy type would be best for your particular situation.

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