



# Buying Life Insurance: Term Versus Permanent

by Steven Merkel, CFP®, ChFC ([Contact Author](#) | [Biography](#))



If you're wondering whether or not you should buy [life insurance](#), ask yourself this one question: "Would my death leave anyone in a financial bind?" If you answer "yes", it may be time to get serious about shopping for life insurance. Life insurance can offer peace of mind, ensuring that your debts or loved ones will be taken care of in the event of your death. But before you buy it, you need to ask yourself if you'll qualify, and whether you should purchase [term](#) or [permanent life insurance](#).

## Who Needs and Qualifies for Life Insurance?

The rule of thumb is once you become a parent, any adult in your house earning income should have life-insurance coverage that will last until your youngest child completes college. If you have large financial obligations such as high credit-card debt or a mortgage, you could use life insurance to ensure that debt is covered. Because life-insurance [death benefits](#) are exempt from federal taxation, many financial planners often use clients' life-insurance benefits to help pay for the [estate taxes](#) generated upon the death of a loved one.

To determine if you qualify, most life-insurance policies require you to undergo a medical exam primarily to check for high cholesterol and blood-sugar levels. Prior to issuing a policy the insurance company will also check things such as your medical history, hobbies, credit rating, alcohol-related issues and driving record, just to name a few. Factors such as age, smoking and prior health issues can also drive up the premiums on a policy.

The two primary methods used to determine the amount of insurance an individual requires are the '[human-life approach](#)' and the '[needs approach](#)'. The first projects an individual's income through his or her remaining working [life expectancy](#), and then the [present value](#) of the life is determined by means of a [discount rate](#). With the needs approach, all reoccurring and unusual expenditures are examined to determine the amount of life insurance needed.

## Term Life Insurance

Term life insurance is pure insurance protection that pays a predetermined sum if the insured dies during a specified period of time. On the death of the insured, term insurance pays the [face value](#) of the policy to the named beneficiary. All premiums paid are used to cover the cost of insurance protection.

The term may be one, five, 10, 20 years or longer. But, unless renewed, the insurance coverage ends when the term of the policy expires. Since this is temporary insurance coverage it is the least expensive to acquire. A healthy 35 year old (non-smoker) can typically obtain a 20-year [level-premium policy](#) with a \$250,000 face value, for between \$20-\$30 per month. Here are the main characteristics of term life insurance:

- Temporary insurance protection
- Low cost
- No cash value
- Usually renewable
- Sometimes convertible to permanent life insurance

### **Permanent Life Insurance**

Permanent life insurance provides lifetime insurance protection (does not expire), but the premiums must be paid on time. Most permanent policies offer a savings or investment component combined with the insurance coverage. This component, in turn, causes premiums to be higher than those of term insurance. The investment may offer a fixed interest rate or may be in the form of [money market securities](#), [bonds](#) or [mutual funds](#). This savings portion of the policy allows the policy owner to build a [cash value](#) within the policy which can be borrowed or distributed at some time in the future.

Here are the main characteristics of permanent life insurance:

- Permanent insurance protection.
- More expensive to own.
- Builds cash value.
- Loans are permitted against the policy.
- Favorable tax treatment of policy earnings.
- Level premiums.

There are three basic types of permanent insurance: [whole life](#), [variable life](#) and [universal life](#). The two most common are whole life and universal life. Whole life insurance provides lifetime protection, for which you pay a predetermined premium. Cash values usually have a minimum guaranteed rate of interest and the death benefit is a fixed amount. Whole life insurance is the most expensive life-insurance product available.

Universal life insurance separates the investment and the death benefit portions. The investment choices available usually include some type of equity investments, which may make your cash value accumulate quicker. As the you can usually change your premiums and death benefits to suit your current budget.

### **Final Tips**

- Consider buying a "break point" level of insurance coverage - better premium rates are given at coverage levels of \$100,000, \$250,000, \$500,000 and \$1,000,000.
- Make sure you obtain an illustration for the policy that you have chosen. If the insurer will not provide you with one, look for another insurance company.

- Always shop for a level-premium policy. Nobody likes a surprise increase in their premium payments! So, before you buy term or permanent insurance make sure your illustration shows that your premium payment is guaranteed not to increase over the duration of your coverage.
- Don't be sold on permanent insurance for the investment or cash-value feature. For the first two to 10 years, your premiums are paying the agent's commission anyways. Most policies don't start to build respectable cash value until their 12<sup>th</sup> year, so ask yourself if the feature is really worth it.
- Determine your desired duration of coverage so that you purchase the correct type of policy and keep your premium payments affordable. If you only need insurance for 10 years, then buy term. Also check out multiple-quality insurance companies for their rates.
- Make sure that your insurance carrier has the financial stability to pay your claim in the event of your death. You can research the financial soundness of your insurer at <http://www.ambest.com>.
- Don't be taken with [riders](#). A very few number of policies ever pay under these riders, so avoid things like the accidental death and waiver of premium riders since they will only jack up your premiums.
- For 24 hours before your medical exam, keep sugar & caffeine out of your system. It's best to schedule your exam early in the morning, and don't consume anything but water for at least eight hours beforehand.
- If your premiums are much too high due to medical reasons or you are denied coverage, check if a group plan is available through your company. These group plans require no medical exam or physical.

## Conclusion

When seeking insurance, don't rush into buying expensive permanent life insurance before considering if term life insurance sufficiently meets your needs. Unfortunately, in many cases the fees charged for policies with investment features far outweigh the benefits. When you purchase life insurance, you're betting that you'll live, but also securing peace of mind in case you're wrong. Don't leave your family unprotected in the sudden event of your death - after all, they are your most important assets.

For related reading, see [Exploring Advanced Insurance Contract Fundamentals](#).



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Steven T. Merkel, CFP®, ChFC, is the vice president of portfolio management for Financial Advisory Consultants LLC in Naples, Fla. Steve is a former U.S. Army air defense artillery officer and has been giving financial advice for more than 12 years. He is a Certified Financial Planner® practitioner and a Chartered Financial Consultant. Merkel has been featured and widely quoted in numerous publications including *The New York Times*, *BusinessWeek*, *Entrepreneur*, *Consumer Reports*, *Investment News*, *Financial Planning Magazine* and *Fidelity's Stages Quarterly*. He enjoys fishing, golf, military history, Miami Hurricane football and relaxing on the beaches of South Florida.

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