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Life Insurance Basics

Life insurance is a contract between you and an insurance company. The agreement is that the insurance company will pay a financial benefit to your designated beneficiaries in the event of your death. The amount depends on your policy. The policy depends on many factors, including what kind of insurance you want, what type of policy is best for you, and the financial goals you have for your insurance policy.

The Two Types of Life Insurance

T

Term life insurance provides coverage for a fixed period of time, normally between 10 and 25 years. Term insurance is generally a good option for individuals, young families or anyone looking for some financial peace of mind during key life stages but may not need coverage for their entire life. Examples might include people paying off a mortgage or paying for their children's education.

- Lower initial premiums
- Higher face amounts or death benefits
- Typically has no cash value
- May be renewable or convertible

P

Permanent life insurance (often called "Whole Life") provides lifetime coverage and consistent premiums. This type of coverage also offers a guaranteed return on your policy's cash value. Permanent life insurance may be a good fit for you if you want life insurance coverage that doesn't expire, or if you want to use your policy for estate planning purposes.

- Cash value accumulates over time
- Ability to borrow against the cash value of the policy
- Provides lifetime coverage, as long as premiums are paid
- Level premiums for the length of the policy
- May offer flexible premium payments
- Options include Whole Life, Universal Life & Final Expense

Types of Insurance Policies

There are multiple policy options for both Term or Permanent insurance. Below are some of the primary options to balance as you research the right policy for you.

Cash Value vs. No Cash Value

While both have a death benefit, the choice here is between normally more affordable term insurance that lasts for specific period of time but which has no cash-value, versus permanent insurance that has a cash-value component that grows over time and which allows you to borrow against it under certain conditions.

Renewable vs. Nonrenewable

Most term life insurance coverage can be renewed, even if your health has changed (new premiums will be higher). A nonrenewable term policy does not continue, and a new policy would be necessary to continue coverage. Permanent life insurance is not renewable because it lasts your life, as long you pay your premiums.

Variable vs. Non-Variable

The investments you will choose (such as stock and bond funds) in a variable life policy directly impact your cash value. These policies have the greatest potential to build cash value but also the greatest risk of losing cash value. Non-variable life policies often have guaranteed minimums for some features (interest or cash value, for example) but not all. Non-variable life policies also have less potential to build cash value than variable life policies.

Whole Life vs. Universal Life

Whole life and universal life insurance are two types of Permanent (cash value) insurance. A key difference between the two is how you pay for the coverage. You typically pay premiums for whole life insurance according to a set schedule. In a universal life policy, you can choose a flexible premium payment pattern as long as you pay enough to keep your policy in force.

Simplified Issue vs. Full Underwriting

In general terms, simplified issue refers to either a product type or an underwriting method that offers quick approval without a medical exam, while the more traditional full underwriting method involves a full medical underwriting, including a medical example.

The Underwriting Process

Traditional term or permanent life insurance policies involve a process called underwriting. This can be one of the most frustrating (and time consuming) parts of the insurance process. During this process, the insurance company reviews your application to assess your risk as a policyholder.

The underwriting process typically involves a health questionnaire and a medical exam. The medical exam is like a shorter version of a medical exam you would receive at a doctor's office. A medical examiner will typically assess your height and weight, take your blood pressure and pulse, and may also take blood and urine samples. The medical exam could include other components as well.

The result of the underwriting process will result in one of two things: denial of coverage, or acceptance. If accepted, the insurance company then determines the premium you would need to pay to have the policy you have applied for. Generally, the factors that affect your premiums include:

- Age
- Gender
- Health
- Tobacco use
- Personal and family medical history
- Career, hobbies and lifestyle
- Driving record

The insurance company may also review the information recorded with the Medical Information Bureau (MIB), a non-profit organization that helps insurance companies evaluate risk and prevent fraud. MIB maintains a database of medical and non-medical information about people who have applied for insurance.

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