

What are the advantages/disadvantages of term and permanent life insurance?



There are pros and cons to buying both term or permanent (cash value) insurance. Each has advantages and disadvantages. One or the other, or both, may be appropriate to meet your insurance needs.

Term Insurance

The *advantages* of term policies include:

- 1. Term premiums are lower than those for permanent insurance so you get more insurance coverage for less money. This allows you to buy more coverage when you need it the most, such as when you have young children.
- 2. Because term provides insurance for a specific period of time, it is ideal for covering specific financial needs such as covering your life until your children are through college, until they are self-supporting, or covering your life until you pay off your mortgage.

The *disadvantages* of term policies include:

- 1. Premiums increase every time a policy is renewed, so the cost of term insurance can become prohibitive as you near your late 50s and 60s.
- 2. Term life doesn't provide a savings feature known as cash value. Term policies only pay benefits if you die while the policy is in force.
- 3. If your insurance company wants you to take a medical exam when you want to renew your policy, you may be turned down if your health condition has deteriorated.
- 4. You could outlive your coverage, because term insurance is generally not renewable after age 70 or 75, depending on your state's insurance regulations.

Permanent (Cash Value) Insurance

The *advantages* of permanent insurance are:

- 1. You lock in a premium rate at whatever age you start the policy and the benefits are guaranteed for as long as you live.
- 2. Your policy accumulates cash value that grows tax-deferred. Your premiums are invested by the insurance company in stocks, bonds, real estate, venture capital and other funds, and you receive a return on your money in the form of annual dividends, which increase your cash value.
- 3. You can tap that cash value while you are alive with low-cost loans. Any outstanding loans will reduce your policy's cash value by the amount of the loan. Or you can withdraw the cash value, though you will have to pay income taxes on those withdrawals. You can also convert your cash value into an annuity that will provide fixed-income throughout your retirement years.
- 4. If you surrender your policy by discontinuing to pay premiums, you will receive any accumulated cash value.
- 5. Dividends can be used to pay your premium in whole or in part.
- 6. Once you have passed the medical tests and have been issued a policy, your policy cannot be cancelled for medical or any other reasons if you continue to pay the premium.

The *disadvantages* of permanent insurance are:

- 1. It is far more expensive than term insurance. This means that you can usually afford far less permanent coverage than you can afford term. If you start a permanent policy and then must drop it because you cannot afford the premiums, you will have lost a great deal of money.
- 2. Insurance companies invest your cash value quite conservatively so it is possible that you could earn higher returns on your own if you are a skillful and knowledgeable investor.
- 3. The return you earn on your cash value is determined by current interest rates in money markets. So if interest rates are high, your cash value will grow much more quickly than if interest rates are low. Periodically, the insurance company deducts its expenses and a mortality charge from your cash balance. The mortality charge is the amount of money, based on a premium rate per thousands of dollars of death benefits, required to provide you with life insurance. The company will guarantee a minimum interest rate and a maximum mortality charge. Some will also guarantee a maximum expense charge.