

What Type of Life Insurance Do I Need?

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About 11 million U.S. households with children under age 18 had no life insurance coverage as of 2010, according to LIMRA, a worldwide research and consulting organization for the insurance and financial services industry. Overall, less than half of U.S. households had individual life insurance, a 50-year low. That means if the breadwinner or the person responsible for childcare and household management died prematurely, the loss of income or need to pay for those services could push the household into poverty. While most consumers begin thinking about life insurance when they get married and start a family, it can be wise to buy a policy even sooner, says Allen C. McLellan, associate dean and an assistant professor of insurance at The American College. In fact, USAA Life Insurance reports that the number of single people buying life insurance is increasing, even as overall sales decline.

“A young single adult who’s not married or not in a relationship certainly needs enough to pay their end-of-life expenses so their parents don’t have to come in and clean up the debts,” says McLellan. Single policyholders who offer financial or caregiving support to parents may want their policy to cover that need as well. Buying a policy while you’re young and healthy also means lower premiums; however, older consumers may also want a life insurance policy to leave a legacy for their children or support a surviving spouse.

Whatever your age or life stage, the first step in purchasing life insurance is conducting a needs analysis. Several online life insurance calculators provide a benchmark, or an insurance agent can discuss your needs. Seven to 10 times your annual salary is a common starting point, but many other factors come into play. “They’re going to look at your ongoing expenses, your mortgage, your rent, are you paying tuition?” says Whit Cornman, a spokesperson for the American Council of Life Insurers. “Also consider immediate expenses, medical bills, burials costs, the fact that the family may need money to move if they’re going to have to switch jobs.”

For a spouse who doesn’t work, “Consider what do you think are the costs of replacing that person?” urges Cornman. “For people who do the cooking, take care of the household, day care expenses. If they’re a stay-at-home-parent, what are going to be the costs of that?”

In general, people tend to underestimate their needs. And as Marvin Feldman, president and CEO of

the Life and Health Insurance Foundation for Education LIFE), a nonprofit that educates consumers about financial planning and insurance, points out, in this market, people need more capital to earn the same amount of interest that they did a few years ago.

Life insurance comes in many different varieties, so once you've determined your needs, an insurance agent can help choose a policy to match. Term life insurance insures you for a specified time frame, say 15 or 20 years, while permanent insurance remains in force as long as you continue paying the premiums. Permanent life insurance is sometimes also called cash-value insurance because it can accumulate savings on a tax-deferred basis. Whole life, variable life, and universal life are all specific types of permanent life insurance.

"Term is very simple to understand," says McLellan, who compares term life insurance to paying rent. "When I stop paying the rent, I would lose the coverage. That's why many young people buy term life insurance off the Internet. Once I get into the complexities of whole life insurance or universal life, the game changes. Anything more than term is generally going to require the services of a licensed agent." According to Amy Bach, executive director of United Policyholders, a nonprofit organization that provides insurance resources to consumers, the most commonly purchased option is a term life policy with a flat annual premium or semi-annual premium. "The problem with the term life policy," she continues, "is once the term expires, the premiums will go through the roof."

One way to handle this issue is by laddering policies. "That is, buy another policy before the end of the term so that coverage will continue," explains Cornman. "Some policies will let you continue coverage at the end of a term. You would likely pay a higher rate, but it still may be a better option than seeking out a new policy, which may be very costly or difficult to get at an advanced age."

That said, life insurance may still be within reach because "companies are becoming much more efficient at keeping cost ratios down, so it's probably less expensive than it's ever been," according to Feldman. "Not that finding the least-expensive price is most important."

Experts stress that whether you buy life insurance online or through an agent, choosing a reputable company with a record of good customer service is a must. "You want to purchase insurance from a company that has a history of paying claims, that has a strong financial rating, and there are fairly easy ways of discovering these things," says Larry P. Ginsburg, an Oakland, Calif.-based certified financial planner and a board member of United Policyholders. Ratings companies like Standard & Poor can offer insights into an insurance company's financial stability.

Consumers should also be wary of insurance products that are overly complicated or over-promise. "One of the biggest areas where consumer advocates have been working is to protect seniors who get sold these new complicated life insurance policies that are really more like investment products," Bach says.

“The senior thinks they’re going to see some benefit while they’re alive, but they’re so complicated and there are so many unknowns that it’s not a suitable product for that person because of their advanced age.” She suggests avoiding shady pitches by asking friends and family for a referral to a reputable insurance agent.

Once you have a life insurance policy in force, it’s recommended that you review your policy and beneficiaries every 12 to 18 months to ensure they’re up to date. As Feldman points out, if you’ve gone through a divorce or gotten married and forget to update your beneficiaries, that can lead to problems when you die. “It’s really important to make sure that those things are done properly,” he stresses. Knowing you have the right life insurance policy and the right beneficiaries offers peace of mind that your loved ones will be taken care of should you pass away.

Additional Resources:

ACLI’s Life Insurance Buying Tips

LIFE’s Guide to Life Insurance

Standard & Poor’s Insurance Ratings

United Policyholders’ How to Do a ‘Needs Analysis’ Before you Buy Life Insurance