Money matters Life Insurance

The death of a loved one, such as a spouse, may bring financial loss that can derail your future financial security. The purpose of life insurance is to replace lost income and pay off debts. So when a person dies, survivors do not have take on a financial burden for which they're not prepared.

Like most important financial decisions, figuring out whether you need life insurance, the type and how much, can be complicated. To make a good decision, you should answer these questions for yourself and your family:

- Do I need life insurance?
- How much do I need?
- What type should I buy?
- Is the company selling the policy in good financial shape?
- How can I get the best price?

Analyzing Your Need

Do you have loved ones who depend on your income to pay their routine bills?

Do you have a mortgage, children's college loans, business debt or taxes that need to be paid off if you died? Do you have enough money saved to pay your funeral expenses?

These are difficult questions to think about. If you're single, with no children or parents to support, and if you have a good nest egg, you may not need life insurance. But if you answered any of these with a yes, you should seriously consider whether you need to buy a policy.

Estimating the Amount of Coverage

Start by making two lists. The first one should be a list of savings, home equity, investments, a business or any other assets you have to cover expenses if you or your spouse dies. The second list should include all the expenses that need to be covered, both immediately and over a period of years, if you or your spouse dies. Be sure to include health insurance costs, especially if your spouse gets health coverage from the policy you have at work.

This list should include an estimate of what the annual expenses would be. For example, suppose you died at age 60, before retiring, and your spouse is 55 and earns less than half of the income that pays the bills for both of you. What assets or income (such as Social Security survivor benefits) would your spouse have to pay current bills and to live on in retirement? Remember that although Social Security may pay a lump-sum death benefit to the spouse or child of a worker, currently it is only $255, which is unlikely to cover funeral expenses.

Compare the bottom lines of your two lists. If your spouse would have $20,000 a year in income, and need $35,000 to pay necessary expenses, where would the other $15,000 a year come from? If there are no assets, such as savings, to pay those bills, then you should probably look into getting life insurance.

Types of Life Insurance

There are two main types: term insurance and permanent insurance.

Term insurance pays a death benefit if you die within a specific period of time while you are paying for the policy. When you stop paying the premium, your coverage ends. Term insurance is generally most useful if you have a significant financial need, such as a mortgage, that may decline or disappear over the years.

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There are four different types of term insurance:

- **Convertible** term insurance lets you convert the policy into a permanent one at any time. There's no medical exam, but premiums may go up.
- **Renewable Term** insurance lets you sign on for a new term policy without a medical exam, although the premium may be higher.
- **Level** term insurance lets you pay the same premium every year for the length of the term and be entitled to the same amount of proceeds if you die while it's still in effect. If you want to renew it at the end, your premium may rise significantly, since you'll be older.
- **Decreasing** term insurance pays a death benefit that gradually decreases in value over time. Premiums usually remain the same throughout the term.

Permanent insurance. This policy continues until you die (as long as you keep up the payments). It generally costs more than term insurance, and may allow you to build up a balance of cash over the years. If you change your mind about the policy or need access to the money you've accumulated, you can cash out this type of policy and, in some cases, borrow on it. Here are some of the types of permanent insurance:

- **Whole life** lets you pay a fixed premium for a fixed death benefit. There is a cash savings feature that, over time, provides you with a cash reserve.
- **Universal life** is a little more flexible than whole life. You may be allowed to change the amount of insurance coverage as your needs change. Some changes may require a medical exam.
- **Variable life** invests some of your premiums in stocks, bonds, and money market funds. The upside is that your investments may perform well, and provide a larger cash reserve. The downside is that the investments could lose money, and policies usually do not guarantee a minimum cash value. Most insurers guarantee a minimum death benefit, although it may not be what you had hoped to receive.
- **Variable-universal life** combines the premium and death benefit flexibility of universal life with the investment flexibility and risk of variable life insurance.

Insurance Company Strength

Before buying, make sure that the company selling the policy is in good financial health, so that the benefits will be paid in the future. See "Your To-Do List" for sources that can provide you with insurance companies' financial ratings. You can also check with the office of your state insurance commissioner.

Finding the Best Price

Comparison shop for a policy. See if your employer offers life insurance to employees. Look at the amount of the benefit and costs you would have to pay, and compare them with similar policies you might buy from an insurance broker or agent. Getting the insurance through your employer or another group policy—for example, through a professional organization or a union—is usually cheaper than buying individual coverage.

Your To-Do List:

- ☐ **Use the online calculator** from the American Savings Education Council (ASEC) to estimate how much life insurance you need: http://partners.leadfusion.com/tools/choosetosave/lifeins01/tool.fcs.
- ☐ **On the ASEC website,** check out the list of “life insurance calculators” to help you decide which type of policy may be best for you, www.choosetosave.org/calculators.
- ☐ **Read “What You Should Know About Buying Life Insurance,”** published by the American Council on Life Insurance, at this federal government website, www.pueblo.gsa.gov/acli/buying_insur.pdf.
- ☐ **Check the financial status of the insurance company** offering the policy to see if it will be financially sound when, or if, it comes time to pay your claim. Contact the office of your state insurance commissioner, available on the website of the National Association of Insurance Commissioners, www.naic.org/state_web_map.htm or the rating services listed on AARP’s website at www.aarp.org/money/financial_planning/sessionfive/life_insurance.
- ☐ **Read about the Social Security** lump-sum death benefit on the agency’s website, www.ssa.gov/online/ssa-8.