

# Buying Life Insurance



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Alabama Cooperative Extension System, Alabama A&M and Auburn Universities

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## **Buying Life Insurance**

Deciding what life insurance policy to buy can be difficult. When there are so many choices, how do you know what insurance is right for you? There are advantages and disadvantages of having choices.

The main reason for buying life insurance is to protect your family against loss of income (the income your family would lose if you should die before saving enough money to provide for them). There are two basic types of life insurance, permanent and term.

### **Permanent Insurance**

Permanent life insurance—whether it is whole, variable, universal, or a combination of these—has some advantages. These are: forced savings, **tax-deferred income**, the ability to borrow, **extended term**, **paid-up additions**, and investment potential. Permanent insurance also protects against the money loss that would occur from your death. You pay for these extra features in higher premiums.

### **Term Insurance**

Term life insurance provides income for your beneficiaries only if you die during the insured period. In the early years, term insurance costs much less than permanent insurance. Term insurance has no savings feature. Because of this, some experts suggest that you buy term insurance and save the difference between the cost of term and permanent insurance. They suggest you put the money saved in an investment which earns a higher rate of interest than that guaranteed on the savings portion of permanent insurance. According to these experts, if you do this, term insurance will be the best buy.

### **What To Buy**

Before buying insurance, you must decide what is right for you and your family. Don't forget, your family also may be protected by such plans as Social Security, veteran's benefits, or other savings plans.

Before you decide on term or permanent insurance, think about how well you can save. Permanent insurance

forces you to save through the build-up of cash value. Depending on the kind of policy you have, the rate of return may be low. Sometimes a cash value policy must be held for several years because most have no cash value at the end of the first few years. If you drop a cash value policy too early, you will lose money.

Studies show more than 20 percent of people buying cash value (permanent) policies lose their policies within 2 years of purchase. More than 50 percent lose them within 10 years.

Think about your tax situation. If you are in a high tax bracket, permanent insurance may be good because the savings built up in the policy are tax-deferred. Also the face value of a life insurance policy will be available to your family immediately after your death. With ordinary investments your family may have to wait for the benefits or be forced to sell investments at a loss.

Death benefits of any life insurance policy, permanent or term, are not taxable for income tax purposes. However, life insurance held in your name is added to your **taxable estate** for estate tax purposes. That is, if you own the policy and pay the premiums, when you die the insurance proceeds will be added to your other property to determine death taxes. Each person can leave property of up to \$600,000 to heirs without paying federal estate taxes. Contact your county Extension office for more information on estate planning.

## **Should You Switch Policies?**

Think hard before switching life insurance companies or policies. When you have term insurance, some experts suggest switching companies every few years because premiums for a new policyholder are often less than for an existing policy owner. You may want to consider switching a policy if you're getting a poor rate of return or if the policy no longer meets your needs. However, some companies refuse to insure people who switch policies often, or they demand premiums for a certain number of years in advance if you get a replacement policy.

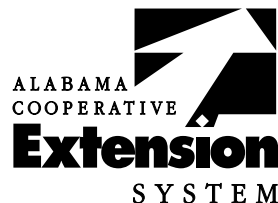
Also, replacing an old policy costs money because most of the **commission** and management expenses come out

of your premiums the first year. When you replace a policy, you pay the sales and other “first-time” charges all over again. Your current policy could be valuable if it has low loan rates, such as 5 percent or 6 percent. And, if your health has gotten worse or if you smoke, your premiums for a new policy will cost more.

You might be able to combine an older policy with a low **face value** into a new policy with a larger face value. If you don’t smoke and your old policy did not account for that, your application for a new policy might be accepted in the company’s lowest rate group.

Before you switch policies, write to the company holding your old policy and ask for a cost breakdown—premiums, **cash surrender value**, and **death benefits**. Get the same information on the new policy, and compare the costs carefully.

**If you decide to switch policies, always make sure your new policy is in effect before canceling the old one.** Remember, an old “not so good” policy may be a better deal than a new “good” policy when you consider all the conditions. Also remember, a policy that is good for one family may not fit your family at all.



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**For more information**, call your county Extension office. Look in your telephone directory under your county’s name to find the number.

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