Types of Life Insurance

The two main types of life insurance are term and permanent. But within these two categories there are various types of policies to choose from.

Different types of life insurance

Common types of life insurance include:

- **Term life insurance.**
- **Whole life insurance.**
- **Universal life insurance.**
- **Variable life insurance.**
- **Simplified issue life insurance.**
- **Guaranteed issue life insurance.**
- **Group life insurance.**

All types of life insurance fall under two main categories:

1. **Term life insurance.** These policies last for a specific number of years and are suitable for most people. If you don't die within the time frame specified in your policy, it expires with no payout.
2. **Permanent life insurance.** These policies last your entire life and usually include a cash value component, which you can withdraw or borrow against while you're still alive.

Term life insurance

How it works: Term life insurance is typically sold in lengths of one, five, 10, 15, 20, 25 or 30 years. Coverage amounts vary depending on the policy but can go into the millions. "Level premium" term life insurance locks in the same price for the length of the policy. "Annual renewable" term life is a one-year policy that renews every year. Annual policies can be useful if you have short-term debts or need coverage for a brief period of time.

- **Pros:** It's often the cheapest way to buy life insurance. You can get life insurance quotes online.
- **Cons:** If you outlive your policy, your beneficiaries won't receive a payout.

Whole life insurance

How it works: Whole life insurance typically lasts until your death, as long as you pay the premiums. It's the closest thing to "set it and forget it" life insurance. In general, your premiums stay the same, you get a guaranteed rate of return on the policy's cash value, and the death benefit amount doesn't change.

- **Pros:** It covers you for your entire life and builds cash value.
- **Cons:** It's typically more expensive than term life or other permanent policies.

Universal life insurance

Guaranteed universal life insurance

How it works: The death benefit is guaranteed and your premiums won't change. There's typically little to no cash value within the policy, and insurers demand on-time payments. You can choose the age to which you want the death benefit guaranteed, such as 95 or 100.

- **Pros:** Due to the minimal cash value, it's cheaper than whole life and other forms of universal life insurance.
- **Cons:** Missing a payment could mean you forfeit the policy. And since there's no cash value in the policy, you'd walk away with nothing.

Indexed universal life insurance

How it works: Indexed universal life insurance links the policy's cash value component to a stock market index like the S&P 500. Your gains are determined by a formula, which is outlined in the policy.

- **Pros:** You can access cash value, which grows over time. And you may see considerable gains if the stock market performs well. Within limits, your payments and death benefit amount are flexible.
- **Cons:** Due to investment caps, the cash value doesn't take full advantage of stock market gains. Plus, these policies are often more work than a term or whole life product, as the investments require monitoring.

Participation rate: The policy will dictate how much your cash value "participates" in any gains. For example, if your participation rate is 80% and the S&P 500 goes up 10%, you get an 8% return. If the index goes down, you won't lose cash value; you'll just get zero rate of return. Some policies offer a small guaranteed interest rate in case the market goes down.

Cap on gains: Your cash value gains are subject to a cap. So if the index goes up 20% and your cap is 10%, you'll get only a 10% return.

Death benefit and flexible premiums: Some policies let you adjust your death benefit as your family's needs change. Within limits, you can also decrease your premiums or skip a payment, as long as your cash value covers the costs. If you're skipping payments and you don't have enough cash value to cover the costs, your policy could lapse.

Variable and variable universal life insurance

How they work: The cash value in variable life and variable universal life insurance is tied to investment accounts, such as bonds and mutual funds. Variable life insurance premiums are typically fixed and the death benefit is guaranteed, regardless of how the market fares. In contrast, variable universal life insurance premiums are adjustable, and the death benefit is not guaranteed. If you're considering a policy like this, a fee-only financial advisor — a planner who doesn't earn commissions based on product sales — can help you select the best one.

- **Pros:** There is potential for considerable gains if your investment choices do well. You can take partial withdrawals from the cash value or borrow against it.
- **Cons:** It requires you to be hands-on in managing your policy as the cash value can change daily based on the market. Fees and administrative charges are deducted from your payment before going toward the cash value.

Types of life insurance by underwriting

The term "underwriting" refers to how a life insurance company calculates the risks of insuring you. Therefore, the policy's underwriting determines how much you'll pay. There are three main types of life insurance underwriting:

Fully underwritten life insurance

If you're healthy, fully underwritten policies will generally be the cheapest option. This is because the application process typically includes a medical exam and questions about your health, as well as questions about your family's health history, your hobbies and your travel plans. Insurers use this data to price the policy more accurately based on your specific life expectancy.

Simplified issue life insurance

Simplified issue policies don't require you to take a medical exam. However, you may be asked a few health questions and could be turned down based on your answers. Instant-approval life insurance policies use quick, online health questionnaires, as well as algorithms and big data to speed up the application process.

Guaranteed issue life insurance

Guaranteed issue life insurance requires no medical exams and no health questions. In short, you can't be turned down for coverage if you're within the eligible age range, which is typically 40 to 85. However, this is an expensive way to buy life insurance, and coverage amounts are generally low.

In addition, these policies have graded death benefits, which means if you die within the first few years of having the policy, your beneficiaries may receive only a partial payout. People often buy this type of life insurance if they've been turned down elsewhere due to their health but they want to cover final expenses, such as funeral costs.

Other types of life insurance

- **Group life insurance** is typically offered by employers as part of the company's workplace benefits. Premiums are based on the group as a whole, rather than each individual. In general, employers offer basic coverage for free, with the option to purchase supplemental life insurance if you need more coverage.
- **Mortgage life insurance** covers the current balance of your mortgage and pays out to the lender, not your family, if you die.

- **Credit life insurance** pays the balance of a specific loan, like a home equity loan. Your bank might offer to sell you a credit life insurance policy when you take out a loan. If you die, it pays off the lender, not your family.
- **Accidental death and dismemberment insurance** covers you if you die in an accident, such as a car crash. AD&D insurance also pays out for the loss of limbs, as well as the loss of your sight or hearing.
- **Joint life insurance** insures two lives, usually those of spouses, under one policy:
    - **First-to-die:** Pays out after the first policyholder dies. The policy would then expire; it doesn't continue to cover the second person. These policies are extremely rare as the demand for them is low.
    - **Second-to-die:** Pays out after both policyholders die. These policies can be used to cover estate taxes or the care of a dependent after both policyholders die.