The Primary Types of Life Insurance & How Their Cost is Determined

There are many forms of life insurance policies available to a potential policyholder but all life insurance policies will always fall under two different categories:

Term Life Insurance - these types of policies are only active for a specified amount of time of your life, called a "term". When the term ends, so does the policy. Payout only occurs should the insured die sometime within the policies defined term. This type of life insurance is best used for temporary or shorter term needs: 20-year mortgage, college education costs for children, and helping to support children and assist with family income needs should one of the parents die.

Permanent Life Insurance - this type of policy covers you for your entire life and will pay death benefits when you eventually die. This type of insurance policy is best for "permanent" related needs: burial fees, estate taxes, providing income for a spouse, etc.

Whichever type of insurance policy you choose, there are two factors that determine its cost: Mortality Cost and Policy Expense Cost.

Policy Expense Cost is the cost of insurance company expenses such as office rent, utilities, general staff, and agent commissions. Depending on the type of policy you purchase, this fee can either remain constant or fluctuate throughout your policy's lifespan.

Mortality Cost is determined by the odds of the insured dying at that particular moment. Obviously, the odds of the insured dying increase exponentially with age. To avoid an ever increasing insurance premium that correlates directly with the insured's aging, insurance companies average the increase and adjust the early premium payments accordingly. Essentially, you are paying an inflated premium when the insured is younger and a much lower premium as the insured individual ages, but the actual payment remains constant. This overpayment is called "cash value" and must be reimbursed to the policyholder should he or she cancel an existing permanent life insurance policy early. It is important to note that Term Insurance premiums increase with the policy holder's age but they will never accrue a "cash value". When a Term Insurance policy is terminated early, there is no refund for overpayment due from the insurer.

Additional life insurance terms you should know:

Beneficiary - This is the person or organization to whom the insurer will pay proceeds to should the insured die. This could be your husband/wife, or your spouse. It could also be your children or a perhaps your favorite charity.

Primary Beneficiary - This is the person or organization that will be paid upon the insurer's death.

Contingent Beneficiary - This is the person or organization to which the proceeds will be paid to should the Primary Beneficiary be dead or no longer exist (such as a company or corporation named as the Primary Beneficiary). If no Contingent Beneficiary was named in the policy, proceeds will be paid to the Primary Beneficiary's estate.

Face Amount - This is the amount of money payable at time of death. It is usually found on the first page of every Life Insurance policy, whether it's a Term or Permanent policy.

Purchase Options - These are options that can be purchased throughout the life of the policy regardless of the insured's health. A good example of a purchase option is allowing the policyholder to increase the amount of the policy without having to re-evaluate the health of the insured.

Waiver of Premium - This is an optional coverage that permanently suspends your premium in the event that you are disabled. However, you must first be disabled for six months before the waiver takes effect. Additionally, this option is quite expensive and may not be necessary should the insured have substantial disability coverage.

About the Author

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