Term vs. Whole Life Insurance – Which is best for you?

Term life and whole life are two popular variations of life insurance policies. While the basic idea of providing much-needed cash in the event of your death is the same, there are some big differences between the costs and benefits of each one. Here's a rundown of both varieties, so you can make the best decision for your family.

Term life insurance is the lower-cost option

Term life insurance is perhaps the purest way to protect your loved ones in the event that you die prematurely.

In a nutshell, when you buy a term life insurance policy, the period of protection is temporary (10, 20, and 30 years are most common). After the initial term runs out, policyholders have the option to renew, but by that point, the renewal rate is often prohibitively expensive.

Term life insurance policies don't accumulate any cash value. Simply put, if you die while the policy is active, the policy's beneficiaries collect the death benefit. If not, the policy expires, and the life insurer has no further obligation to you. For this reason, term life insurance is significantly cheaper than whole life insurance.

In most term life policies, the premium stays the same for the initial term, known as level premium, and the death benefit remains the same. In addition, there are other variations of term life policies, such as decreasing term insurance, under which premiums remain the same, but the death benefit is reduced every year. This can be a smart way to protect against your heirs' need to repay large debts, such as a mortgage, and is often known as "credit life." In other words, since your mortgage balance typically declines every year, the need to insure against the debt also declines.

Regardless of what form it takes, term life insurance is a cost-effective way of meeting a temporary insurance need.

Whole life can offer lifelong protection but at a higher price

As the name implies, whole life insurance is designed to protect you for your entire life. Premiums are significantly higher than term life policies, not only to compensate for the higher mortality risk in your later years, but because whole life policies accumulate cash value over time. Since whole life policies build cash value, they can be included in retirement planning, and one big advantage is the ability to borrow against the policy.

The purest form of whole life insurance is known as traditional ordinary life, or straight life. These policies have a fixed premium that's guaranteed until age 100, at which point the cash value of the policy will equal the death benefit. If the insured is still alive at 100, this amount is paid to the policyholder.

In addition, there are several other varieties, which include (just to name a few):

- Limited pay -- Premiums are only paid for a certain amount of time, such as for 20 years or until age 65. Premiums will be higher since you're paying for a limited time.
- Single pay -- Instead of paying monthly or annual premiums, a single lump-sum premium is paid at the policy's inception.
- Graded premium -- Premiums gradually increase over a certain time period.
- Adjustable life -- Death benefit or premiums may be modified over time.

Whole life policies are good for a permanent insurance need. For example, if you'd like to leave your heirs $500,000 whenever you pass away, a whole life policy can allow you to ensure that will happen. Whole life can also be useful as a savings vehicle that can be borrowed against if necessary:

Which is best for you?

It depends on your personal situation and goals. You may want to use term life insurance if you prefer to keep your premiums low and invest the majority of your extra money. The idea is that by the time your term life policy runs out, your retirement accounts and other investments will be built up to the point where the death benefit is no longer necessary..

On the other hand, if you want insurance that doesn't expire, and the idea of building up cash equity is more appealing to you than simply "renting" a life insurance policy, whole life could be the best option for you.

*See the original article at: https://www.fool.com/retirement/2017/07/20/term-vs-whole-life-insurance-which-is-best-for-y-2.aspx